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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - Appellant

versus

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - Appellee

On Appeal from the Court of Appeals of Kentucky

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

I. Is Kentucky's unique three factor income tax apportionment formula for trucking companies invalid under the Due Process Clause of the Fourteenth Amendment to the United States Constitution when:

(a) The formula excludes Appellant's principle assets, its interstate rolling stock, from the property factor, leaving only Kentucky property,

(b) The formula assigns all interstate drivers' wages solely to Kentucky in the payroll factor, leaving only Kentucky payroll,

(c) The formula inevitably leads to approximately 130 to 143 percent of Appellant's net income being subject to the power of the various States to tax because it is so out of step with the Constitutionally correct formulas of other States, and

(d) The formula results in the actual double taxation of Appellant?

II. Is Kentucky's unique formula invalid under the Commerce Clause because it fails to provide fair apportionment?

III. Did Appellant waive its federal constitutional rights?

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v.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - *Appellee*

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

JURISDICTIONAL STATEMENT

Appellant, Liquid Transporters, Inc. ("Liquid"), appeals from the judgment of the Court of Appeals of Kentucky ("Court of Appeals"), which upheld the right of the Kentucky Revenue Cabinet ("Revenue Cabinet") to compute Liquid's Kentucky corporate income tax on the basis of a unique three-factor apportionment formula set forth in the applicable Kentucky statute and regulations.

The only parties to these proceedings are Liquid[1] and the Revenue Cabinet.

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[1]Liquid Transporters, Inc. is a Kentucky corporation wholly owned by Trimac Transportation Inc., a Delaware corporation wholly owned by Trimac Holding, Inc., a Delaware corporation wholly owned by Trimac, Inc., a Delaware corporation wholly owned by Trimac, Ltd., a corporation organized under the laws of the Province of Alberta, Canada. Liquid Transporters, Inc. has no subsidiaries that are not wholly owned. This information is included pursuant to Rule 28.1.

OPINIONS BELOW

Set out in the Appendix hereto are (a) the decision of the Court of Appeals (Appendix A) from which this appeal is taken on the federal constitutional issues decided therein, (b) the order of the Supreme Court of Kentucky (Appendix B) denying discretionary review, (c) the decision of the Jefferson Circuit Court (Appendix C) from which an appeal was taken to the Court of Appeals, and (d) the Opinion and the Findings of Fact and Conclusions of Law of the Kentucky Board of Tax Appeals (Appendix D) from which an appeal was taken to the Jefferson Circuit Court.

JURISDICTION

The Court of Appeals rendered is opinion on November 7, 1986 (Appendix A). The Supreme Court of Kentucky denied Liquid's motion for discretionary review on January 13, 1987 (Appendix B).

A notice of appeal was filed in the Court of Appeals on March 31, 1987 (Appendix E). The time within which to docket this appeal in this Court expires after April 13, 1987, and timely docketing has been made. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

KRS 141.120 as in effect during the tax years at issue, 1974-1978, constituting Kentucky's allocation and apportionment system, is set forth in Appendix

F.[2] The Revenue Cabinet's regulations thereunder applicable to this case are 103 KAR 16:090 and 103 KAR 16:120, which are set forth in Appendix G and Appendix H respectively. The relevant provisions of the United States Constitution are the Due Process Clause of the Fourteenth Amendment and the Commerce Clause (U.S. Const., Art. 1, §8, cl. 3).

STATEMENT OF THE CASE

Liquid is a Kentucky corporation based in that State and engaged in the business of hauling commodities by truck in interstate commerce.

The Revenue Cabinet is the agency of the Commonwealth of Kentucky empowered by statute to collect the Kentucky corporation income tax.

Liquid's appeal arises from the assessments of the Revenue Cabinet for additional income tax for 1974 through 1978, totaling $107,988, plus interest, under the applicable Kentucky statute and the regulations promulgated thereunder by the Revenue Cabinet. The courts below found an assessment for 1973 barred by the Kentucky statute of limitations.

The assessments arise from Kentucky's unique method of applying the three factor apportionment formula generally favored by this Court.[3]

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[2]KRS 141.120 was amended in 1976 in a manner irrelevant to the substance of this case. The numbering of its subsections was changed in the amendment to the system currently in use. Appendix F reflects the change.

[3]This Court has noted that the three factor (property, payroll, and sales) formula for apportioning taxable income of corporations

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The assessments violate the federal due process rights of Liquid because it has proven by clear and cogent evidence that they are based on the attribution to Kentucky of a portion of the taxable income of liquid that is out of all appropriate proportion to the business of Liquid transacted in Kentucky and lead to a grossly distorted result. *Container Corporation of America* v. *Franchise Tax Board,* 463 U. S. 159, 170 (1983).

The assessments also violate Liquid's rights under the Commerce Clause because Kentucky's apportionment formula is so radically different from the unquestionably fair method of mileage based apportionment approved by this Court in *Central Greyhound Lines, Inc. of New York* v. *Mealey,* 334 U.S. 653 (1947) that it can be seen to violate the Commerce Clause on its face.

Liquid raised these federal constitutional questions in each of the proceedings below.[4]

1. *Liquid's Trucking Business.* During each of the five taxable years at issue in this case, Liquid was

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operating in several states is in regular use. See, *e.g., Container Corporation of America* v. *Franchise Tax Board,* 463 U.S. 159, 170 (1983). The three factor formula is included in the Uniform Division of Income for Tax Purposes Act, substantially all of which had been adopted by Kentucky and at least 22 other States in 1982. See *ASARCO, Inc.* v. *Idaho State Tax Comm'n,* 458 U.S. 307, 310, n. 3, (1982).

[4]See Appendices A, C, and D. The Jefferson Circuit Court failed to refer to the Commerce Clause in its Memorandum Opinion (Appendix C), but dealt with Appellant's Commerce Clause in the first segment of its Opinion regarding fair apportionment and *Central Greyhound.*

engaged in the business of hauling commodities over the road through 46 or more States. (ICC Reports, Appellee's Exhibit 2).[5] It derived substantially all of its revenues from these transportation operations. (TE pp. 18-19).

The miles driven by Liquid for those years were as follows (Stipulation 1.1):

Taxable Year	Miles in Kentucky	Total Miles	% of Miles in Kentucky
1974	5,102,215	13,986,440	36.4797%
1975	4,206,536	10,842,562	38.7965%
1976	4,563,350	12,560,004	36.3324%
1977	5,166,974	14,120,414	36.5922%
1978	5,123,196	14,023,530	36.5329%

Most of the trips originated in Kentucky and were to destinations outside Kentucky. Many of the trips were entirely outside Kentucky. (TE pp. 70-72).

Liquid obtained the necessary permits and licenses to allow it to operate in 46 to 48 States during the years at issue and filed fuel tax returns in all of those States having fuel tax requirements. (TE pp. 26-27).

Liquid was headquartered in Kentucky during all of the years at issue and the majority of its executive and administrative functions were carried out at its Louisville, Kentucky headquarters. (Stipulations 3.1

[5]The record of the proceedings below has not been numbered serially. References are therefore made to individually described documents and internally numbered pages therein. Reference to "TE" is to the Transcript of Evidence taken at the May 4, 1983 hearing before the Board of Tax Appeals. Pursuant to Rule 13.1, Appellant has not acted to certify the record prior to action by this Court on this Jurisdiction Statement.

and 3.4). Its only truck maintenance facility was located in Louisville, Kentucky (TE pp. 73-74) and all of the real estate it leased or owned was in Kentucky (Stipulation 4.1). As the Court of Appeals observed (Appendix A, 721 S.W.2d at 725), Liquid benefited from Kentucky's workers' compensation law and unemployment insurance laws, and most of its bulk shipments originated from Kentucky.

As an irregular route common carrier, Liquid did not pick up shipments and take them to its facilities for storage and then delivery over-the-road to a distant terminal for pick-up. Instead, it picked up liquid commodities at the shipper's site and hauled them directly to the ultimate destination. Thus Liquid, unlike regular route common carriers of its size, did not have terminals located in the various States in which it operated. (TE pp. 92-93).

Without any real properties other than its headquarters and maintenance facility, the great majority of Liquid's property consisted of over-the-road equipment used in its trucking operations (TE pp. 35-37 and Appellant's Exhibit 2):

Percentage of Property Consisting of Over-the-Road Property

Taxable Year	Owned Property Only	Owned and Leased Property
1974	83.69%	95.74%
1975	83.72%	95.34%
1976	84.22%	95.84%
1977	85.68%	96.11%
1978	86.83%	96.42%

The majority of Liquid's total wages consisted of drivers' wages (TE pp. 34-35 and Appellant's Exhibit 2):

Taxable Year	Drivers' Wages as Percentage of All Wages
1974	55.81%
1975	50.92%
1976	51.23%
1977	53.94%
1978	53.07%

Although Liquid was headquartered in Kentucky and its principal business activities were directed from that headquarters, Liquid carried out significant portions of its essential operations outside of Kentucky in addition to driving the majority of its miles outside Kentucky.

The warranty repair work on engines was performed outside Kentucky, repair and maintenance was routinely performed along drivers' routes outside Kentucky, and a significant amount of repair and maintenance was performed outside Kentucky under agreements with other carriers. (TE pp. 22-24).

The cleaning-out of Liquid's vehicles was an especially important maintenance activity which, in most instances, was conducted at the location where the liquid commodities were delivered. The majority of those destinations were outside Kentucky. (TE pp. 24-25).

Liquid contracted with six independent owner-operators during the years at issue who were headquartered outside of Kentucky and operated with semi-

autonomy from those non-Kentucky bases of operation. (TE pp. 21-22).

During the years at issue, approximately 25 to 30 percent of Liquid's revenues were first deposited in an out-of-state bank. (TE p. 69). Liquid's principal attorneys were located outside Kentucky. (TE pp. 69-70). Liquid was publicly held during the years at issue, and its shareholders were located in many States throughout the nation. (TE p. 28).

2. *Liquid's Straight Mileage Apportionment.* Liquid has always filed its Kentucky income tax returns using straight mileage apportionment. Under this apportionment method, Liquid has paid tax on a percentage of its business income equal to the percentage of its miles in Kentucky. See table on page 5 above. The straight mileage apportionment method is the method trucking companies are required to use in a majority of the 48 contiguous States levying corporate income taxes.

3. *Kentucky's Unique Formula.* Kentucky adopted in 1966 the principal provisions of the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Kentucky's version of UDITPA generally requires that corporations transacting business in other States as well as Kentucky allocate their non-business income to the situs of the respective items of such income and apportion their business income according to a three factor (sales, property, and payroll) formula. The sum of the non-business income allocated to Kentucky and the business income appor-

tioned to Kentucky constitutes the corporation's "taxable net income" against which the Kentucky corporate rates are applied.

The Kentucky statute adopting UDITPA, KRS 141.120 (Appendix F), contained in subsection (10) a provision allowing the Revenue Cabinet to adopt regulations establishing for "public service companies" a different property factor and sales factor from the regular property and sales factors. That term is defined in the Kentucky statutes to include interstate trucking companies such as Liquid.

The Revenue Cabinet first adopted a regulation (Appendix H) under the new statute in 1972. It described a property factor that was vastly different from the property factor in other States that have adopted UDITPA or that use a property factor in some other form of multi-factor apportionment for State income tax purposes. In addition, the payroll factor under the applicable provision of the Kentucky statute, KRS 141.120(9)(b) (Appendix F), as implemented by the regulation thereunder (Appendix G) resulted in a payroll factor vastly different from that used by other States for trucking companies such as Liquid.[6]

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[6]The Kentucky statute provides that a taxpayer may petition for an alternate apportionment method if the statutory method reaches an unfair result. See KRS 141.120(9) (Appendix F). Liquid attached to its 1971 return, which it filed on extension after the effective date of the new regulation in 1972, a document titled "Petition" requesting that straight mileage apportionment be allowed. (TE pp. 46-47; Appellant's Exhibit 3). The Revenue

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The Kentucky factors for trucking companies, were determined as follows:

(a) Kentucky's property factor *excluded* all over-the-road equipment from both the numerator and the denominator. Other States using a property factor include all such equipment in the denominator and include a portion of that equipment in the numerator equal to the total of such equipment multiplied by the percentage of miles[7] driven in the State to which the apportionment is being made.

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Cabinet had adopted no regulations for the filing of such petitions and made no response to the petition attached to the 1971 return. Liquid filed no additional petitions for succeeding years but continued to use straight mileage apportionment. The Board of Tax Appeals stated in its Opinion (Appendix D) that Liquid failed to petition properly but held that it did *not* thereby waive its right to question the apportionment formula. The Jefferson Circuit Court stated in its Memorandum Opinion (Appendix C) that Liquid waived its rights and erroneously said it was affirming the Board on the issue. The Court of Appeals stated on page 4 of its Opinion (Appendix A) that its holding for the Revenue Cabinet on the underlying federal constitutional issues made it unnecessary to reach the waiver issue. Under the published Kentucky decisions, Liquid had clearly not waived its federal constitutional rights. *International Society for Krishna Consciousness* v. *Commonwealth*, Ky. App., 610 S. W. 2d 910, 912 (1980); *Adkins* v. *Commonwealth*, Ky. App., 614 S. W. 2d 950, 953 (1981). The Revenue Cabinet did not raise the waiver issue in its final ruling from which Liquid petitioned to the Board of Tax Appeals, and the entire record of the proceedings shows Liquid did not make the clear and intentional waiver required to relinquish federal constitutional rights.

[7]The "miles" used vary from State to State. The "miles" used by Liquid in Kentucky, and stipulated by the Revenue Cabinet to

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(b) Kentucky's payroll factor assigned *all* of the wages of the drivers of a trucking company headquartered in Kentucky, such as Liquid, *to Kentucky.* Other States with a payroll factor include all drivers' wages in the denominator but include in the numerator only that percentage of the drivers' wages equal to the percentage of miles driven in the State.

(c) Kentucky's sales factor equaled the total miles driven in Kentucky divided by the total miles driven. Kentucky follows the pattern established by other multi-factor apportionment States in this regard.

With its over-the-road being excluded from both the numerator and the denominator of its property factor, Liquid would have a property factor of one (1). With all of its drivers' wages being considered Kentucky wages for purposes of its payroll factor, Liquid would have a payroll factor of one (1).

The difference between Liquid's miles driven in Kentucky (on a percentage basis) and the percentage of its income Kentucky seeks to tax is as follows (Stipulation 2):

Taxable Year	Percentage of Miles in Kentucky	Kentucky Apportionment Percentage
1974	36.48%	78.83%
1975	38.80%	79.60%
1976	36.33%	78.78%
1977	36.59%	78.86%
1978	36.53%	78.84%

(Footnote Continued From Preceding Page)

be correct, are the total miles driven, which include empty miles, as reported on Liquid's ICC reports (TE p. 82 and Appellee's Exhibit 2). Some other States use revenue miles or ton miles.

4. *Other States' Formulas.* The 48 contiguous States other than Kentucky levying income taxes require trucking companies such as Liquid to apportion their income by using either:

(a) *Straight mileage apportionment*—that is, the single factor apportionment method based on miles driven that Liquid used in paying its Kentucky taxes during the years at issue, or

(b) *Mileage-based multi-factor apportionment*—that is, a system in which (i) rolling stock is included in the numerator of any property factor based on miles driven in the State, and (ii) drivers' wages are included in the numerator of any payroll factor based on miles driven in the State.[8]

Liquid prepared the following computations of the apportionment percentage that would have applied *if* Kentucky had used three factor apportionment allocating drivers' wages and rolling stock on a mileage basis. (TE pp. 34-38; Appellant's Exhibit 2):

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[8]Some states that generally require three factor apportionment require single factor mileage based apportionment for trucking companies. The law and pratice of the other 47 contiguous States is a mixture of statutes, regulations, and administrative pronouncements and procedures. Counsel's source for such statutes, regulations, and administrative practice has been the *State Tax Guide for the Motor Carrier Industry*, a service developed by the American Trucking Association National Accounting & Finance Council in cooperation with Coopers & Lybrand. Counsel's attempts to get this information into the record, and the state of the record in this regard, are discussed below in this Jurisdictional Statement.

Taxable Year	Straight Mileage Apportionment	Three Factor Mileage Apportionment	Kentucky's Apportionment Method
1974	36.48%	46.76%	78.83%
1975	38.80%	49.81%	79.60%
1976	36.33%	47.58%	78.78%
1977	36.59%	47.16%	78.86%
1978	36.53%	47.19%	78.84%

5. *Returns in Other States.* Liquid did not file tax returns in all of the States through which it drove. In 1974, it filed such returns in Indiana and Virginia as well as Kentucky. By 1978, it filed such returns in five other States as well. With all such other States requiring either straight mileage apportionment or mileage base multifactor apportionment, the percentage of Liquid's net income actually taxed by each State other than Kentucky was approximately as follows.[9] The Kentucky percentage is the percentage arising from the Revenue Cabinet's assessments.

[9]The comparative numbers cannot be completely precise because of variations in the determination of taxable income from State to State. They do show, however, *at least* in 1978, *actual double taxation*.

	1974	1975	1976	1977	1978
Kentucky	78.8266	79.5988	78.7775	78.8651	78.8443
Indiana	18.3	22.5	20.8	19.4	15.15
Virginia	.6689	.8235	.826	1.182	1.43
Illinois	.....	.....	.....	5.23	5.8175
Colorado	.....	.....	.....	.18	.165
Kansas	.....	.....	.....	.45	.45
No. Carolina	.....	.....	.....	.....	1.19
Ohio	.....	.....	.....	.....	7.5422
	97.7955	102.9223	100.4035	105.3061	110.5890

6. *The Record.* The factual record in this case arises from proceedings in the Kentucky Board of Tax Appeals. In compliance with the Board's pre-hearing order, of March 16, 1983, Liquid filed, prior to the

hearing, copies of its exhibits. Among those filed exhibits (which are part of the record of this case) is a schedule titled "Apportionment Methods of 48 States" (Appendix I) stating for each of the 48 contiguous States whether such State had a State income tax and, if so, the apportionment method authorized for use in that State by trucking companies such as Liquid.[10] That exhibit showed that all such States levying corporate income taxes, other than Kentucky, (including all such States that had adopted UDITPA) required the use of either straight mileage apportionment or mileage-based multi-factor apportionment.

Liquid sought to introduce, at various points in the hearing, information regarding the apportionment methods used by States of the sort contained in the exhibit Liquid had filed prior to the hearing. Counsel for the Revenue Cabinet objected to the introduction of this evidence on two grounds: (a) the information regarding the apportionment method of other States was "irrelevant" because those methods did not establish or refute the "validity" of Kentucky's apportionment; and (b) the testimony consisted of legal conclusions rather than evidentiary material. (TE pp. 51-52).

The Board of Tax Appeals upheld the objections of the Revenue Cabinet's with respect to some but not all

[10]The compilation was based on information contained in the *State Tax Guide for the Motor Carrier Industry,* published by the American Trucking Association National Accounting & Finance Counsel in cooperation with Coopers & Lybrand, a copy of which was made available prior to the hearing for inspection by opposing counsel and at the hearing for inspection by the Board (TE pp. 50-53).

of the testimony. *All* of the testimony in the record supports the view that all the other 48 States require either straight mileage apportionment or mileage-based multi-factor apportionment.[11]

After the May 1983 hearing, counsel submitted briefs to the Board of Tax Appeals. The Board having ruled that certain of the information regarding other States' apportionment methods should not be allowed as testimony, counsel for Liquid included in his Brief an extensive, updated analysis of the apportionment methods used by all of the 48 contiguous States levying State income taxes.

The Board granted the motion of counsel for the Revenue Cabinet to strike these provisions of the Brief, with no explanation. Thus the Board ruled, in effect, that the statutes, regulations, and administrative practices of other States were (at least to some unspecified degree), (a) not matters of law which Counsel could bring to the Board's attention, and (b) not matters of

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[11]Liquid's chief financial officer testified, based on his personal experience in filing Liquid's State income tax returns in the seven States other than Kentucky described on page 14, that all such other States required either single factor mileage apportionment or mileage based multi-factor apportionment (*i.e.*, rolling stock and drivers' wages assigned by mileage). (TE pp. 39-40). A tax partner in the Louisville office of Touche Ross gave the same testimony with respect to the approximately 15 to 20 States for which he had personally prepared returns. (TE pp. 87-88). An employee of the Revenue Cabinet testified that of the States he had surveyed single factor mileage apportionment is generally used, although there could be variations in the apportionment formulas based on whether total miles, ton miles, or revenue miles were used. (TE pp. 117-119).

fact with any relevancy to the federal constitutional issues before the Board.

On April 9, 1984, the Board entered its Opinion (Appendix D) in favor of the Revenue Cabinet on the federal constitutional issues. Subsequently, on July 25, 1984, it adopted Findings of Fact and Conclusions of Law (Appendix D).

Liquid appealed to the Jefferson Circuit Court, which ruled based on the record established in the Board of Tax Appeals proceedings, in favor of the Revenue Cabinet on the federal constitutional issues. The Circuit Court entered its Memorandum Opinion (Appendix C) on May 23, 1985.

Liquid appealed to the Court of Appeals, which affirmed the decision of the Jefferson Circuit Court in its opinion entered November 7, 1986 (Appendix A). Discretionary review of that decision was denied by the Supreme Court of Kentucky by its order entered January 13, 1987 (Appendix B).

Liquid Transporters filed its Notice of Appeal to the United States Supreme Court on March 31, 1987 (Appendix E).

SUBSTANTIALITY OF THE QUESTIONS PRESENTED

The questions presented in this case are so substantial as to require plenary consideration, with briefs on the merits and oral argument, for their proper resolution. They include issues of national significance.

In *Container Corporation of America, supra,* this Court referred to the three factor apportionment formula based on property, payroll, and sales as a "stand-

ard formula" (463 U. S. at 163) that has not only met this Court's approval but has become "something of a benchmark against which other apportionment formulas are judged" (463 U. S. at 170).

In *Moorman Manufacturing Company* v. *Bair,* 437 U. S. 267 (1978), this Court held that a State's formula which was significantly different from the formulas used by other States could not be held violative of a taxpayer's Due Process and Commerce Clause rights merely because its uniqueness created a risk of duplicative taxation (437 U. S. at 278). This Court stated it is for the Congress, rather than this Court, to adopt rules requiring an absolutely uniform system of apportionment among all the States (437 U. S. at 280).[12]

The Kentucky Revenue Cabinet and the Kentucky tribunals below have relied upon such holdings and statements to enforce and uphold a three factor apportionment system that:

(a) varies significantly from all other apportionment systems used by other States for trucking companies, and

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[12]Although not cited by the Court of Appeals, *Moorman* was heavily relied upon by the Revenue Cabinet. That 5-4 decision is distinguishable here because (a) Kentucky required that certain factors be used in a patently arbitrary and irrational manner, while Iowa's single factor sales formula did not distort Iowa sales on its face; (b) here there is no mere risk of double taxation (cf. 437 U.S. 276-280), as shown in the table on page 14 above it is actual; and (c) the variation in percentages is more than twice as great as it was in *Moorman,* compare table at 437 U.S. 271, n. 4 with table at page 11 above.

(b) requires that two factors (property and payroll) of its three factor formula be irrationally misapplied,

(c) with the result, established in the record of this case, that actual double taxation has occurred, and

(d) with the result that the net income of the Taxpayer is inevitably subject to the power of the various States to levy their respective taxes on a total of approximately 130% to 143% of such income.

Given the broad statements of this Court in its recent decisions supporting the States' use of various apportionment methods, and the three factor formula in particular, Kentucky and other States are likely to issue regulations and adopt administrative procedures that allow them, under the banner of the three factor formula, to reach other unconscionable results.

This Court should use this case to establish an outer limit beyond which the States may not go.

I. Kentucky's Apportionment Method Violates the Due Process Rights of Liquid Transporters, Inc. by Taxing a Percentage of Its Income Out of All Proportion to the Company's Business Transacted in Kentucky and by Reaching a Grossly Distorted Result.

A State's statutory income tax apportionment formula must be struck down as violative of the Due Process Clause when it attributes to the State a percentage of income out of all appropriate proportion to the business transacted by the corporate taxpayer in that State, *Hans Rees' Sons* v. *North Carolina*, 283

U. S. 123, 135 (1930), *or* has led to a grossly distorted result. *Norfolk & Western R. Co.* v. *State Tax Commission,* 390 U. S. 317, 326 (1968); *Container Corporation of America, supra,* 463 U. S. at 170.

All States other than Kentucky use either straight mileage apportionment or mileage based multi-factor apportionment to allocate the income of trucking companies such as Liquid.

Approximately 63 percent of Liquid's income is apportionable to States other than Kentucky under the straight mileage apportionment method. This Court has observed in *Central Greyhound Lines, Inc. of New York* v. *Mealey,* 334 U. S. 653 (1948), in the context of finding a fair apportionment method for a New York gross receipts tax, that "[t]here is no question as to the fairness" of straight mileage apportionment. 334 U. S. at 663.

Thus, under an apportionment method this Court has found unquestionably fair, Kentucky could tax approximately 37 percent of Liquid's net income. Yet Kentucky seeks to tax approximately 79 percent of Liquid's net income.

Kentucky seeks to tax a portion of Liquid's income that is approximately 114 percent greater than the portion of Liquid's income that Kentucky could tax under a system that is unquestionably fair.

The percentage increase in taxable income attributable to Kentucky's unique apportionment method is far above the tolerable margin of error inherent in any formula method of apportioning income. See *Container Corporation of America, supra,* 463 U. S. at 184.

This Court there observed that a 14 percent increase in the percentage of taxable income attributable to a taxing State is certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business. This Court noted that a 14 percent variance was:

> . . . a far cry from the more than 250% difference which led us to strike down the state tax in Hans Rees' Sons, Inc. . . . .

In *Hans Rees' Sons,* North Carolina, pursuant to its statutory apportionment formula, sought to tax between 66 percent and 85 percent of the income of a corporation whose sole manufacturing facility was based in North Carolina. The corporation warehoused certain of its finished goods in New York and conducted a portion of its finishing work there. The North Carolina Supreme Court ruled in favor of the tax.

This Court, in its unanimous decision reversing, found that, although the company's sole manufacturing facility was in North Carolina, evidence offered by the taxpayer, but stricken from the record by the Trial Court, tended to show that an average of only 17 percent of the taxpayer's income had its source in the North Carolina manufacturing operation. The Court noted that the evidence was not altogether clear and that the taxpayer's attempt to segment its incoming to buying profit, manufacturing profit, and selling profit (and to allocate significant portions of that profit to other States) was not based on any statistical certainty.

This Court concluded, however, that based upon the record before it, it was clear that North Carolina's statutory formula operated "unreasonably and arbitrarily" in attributing a percentage to North Carolina "out of all appropriate proportion" to the taxpayer's "business transacted" in North Carolina, 283 U. S. at 135.

Liquid has not attempted to demonstrate the geographic sources of its profit other than by presenting the mileage figures stipulated in this case. This mileage information, given the appropriateness of mileage-based apportionment (as shown in the practices of all other States and the decision of this Court in *Central Greyhound*) is alone sufficient to demonstrate that Kentucky's unique apportionment method violates Liquid's Due Process rights.[13]

The record in this case, therefore, is a firmer basis for overturning the decision below than was the record in *Hans Rees' Sons.*

The percentage variation in this case, however, is not so great. This case thus presents this Court with an opportunity to define with more particularity the bounds beyond which a State may not go without violating a taxpayer's Due Process rights.

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[13]Mileage-based apportionment will be struck down, at least in ad valorem tax determinations, if it can be shown not to reflect the actual location of taxable property. See *Norfolk & Western R. Co.*, *supra*. But here it is stipulated that the stated miles driven by Liquid's trucks and drivers are accurate (Stipulation 1.1). Thus the mileage figures are stipulated to actually reflect the location of the trucks and drivers.

Surely, to tax *more than twice* the income that may be taxed under an apportionment formula this Court has found unquestionably fair is to go too far.

Surely, to eliminate from a property factor assets representing over three-quarters of the value of a taxpayer's property (and *all* the taxpayer's property outside the taxing jurisdiction) is to surrender that reasonable sense of how income is generated that results in the "external consistency" this Court has required. See *Container Corporation of America,* 463 U. S. at 169. If any property factor is to be used, an accounting for trucks is certainly required to reflect a reasonable sense of how a trucking company's income is generated. The same principles hold true for the assignment of drivers' wages.

II. The Kentucky Apportionment Method Violates the Commerce Clause Rights of Liquid Transporters, Inc.

In *Central Greyhound Lines, Inc. of New York, supra,* this Court struck down an unapportioned gross receipts tax applied to a trucking company headquartered in New York State. Central Greyhound Lines, Inc. derived its revenues from transporting passengers between points within the State of New York but over routes that included highways within Pennsylvania and New Jersey. New York sought to tax the total receipts from transportation, while nearly 43 percent of the mileage lay in the other two States. 334 U.S. at 660.

This Court held that the New York tax violated the Commerce Clause rights of the New York corporate

taxpayer and that single factor mileage apportionment should be used to determine the percentage of receipts New York could tax. 334 U. S. at 663-664.

In reaching its holding, this Court made no mention of activities conducted by the corporation outside New York other than driving through the other two States to New York destinations. In this case, by contrast, the record includes instances of significant business activities of the taxpayer, in addition to miles driven, which were conducted outside the taxing State.

In *Central Greyhound,* all of the taxpayer's points of origin and points of destination were in the taxing State. By contrast, the majority of Liquid's destinations were outside the taxing State, and a portion of the trips did not include any mileage in the taxing State.

In *Central Greyhound,* the taxing State sought to tax 100 percent of the receipts instead of the approximately 53 percent the Court found proper. This Court thus found that an 89 percent increase in the receipts attributable to the taxing State over the portion of receipts attributable to the State under the unquestionably fair straight mileage apportionment method was beyond any margin of error tolerable under the Commerce Clause. The degree of error in this case is *greater* than the degree of error this Court would not tolerate in *Central Greyhound.*

Although this case does not deal with an unapportioned gross receipts tax—which this Court has pointed out by its very nature makes interstate transportation bear more than a fair share of the cost of local gov-

ernment whose protection it enjoys (334 U.S. at 663) — this Court found that the straight mileage apportionment method is unquestionably fair as applied in the headquarters State of an over-the-road transportation company. Although this Court's published opinion in *Central Greyhound* does not describe the executive offices, maintenance properties, passenger facilities, and other properties the corporate taxpayer doubtless had located in its headquarters State, nor the substantial benefits flowing to that corporation from its New York citizenship, this Court surely took such factors into account in determining that straight mileage apportionment was an apropriate method to use in apportioning gross receipts to the headquarters State.

In this case, the Court of Appeals of Kentucky simply failed to understand and apply the ruling of this Court in *Central Greyhound*. It stated (Appendix A; 721 S. W. 2d at 724):

> We find Central Greyhound distinguishable. In effect, that Court ruled that the method for appropriating [sic] income to a state must be a fair method. By no means did it mandate a straight mileage method of apportionment. Rather, the Court ruled that under the existing taxing scheme of New York, an unapportioned gross receipts tax levied on interstate business violated the Commerce Clause.

Liquid has never argued that straight mileage apportionment is "mandated" by any decision of this Court. Liquid has steadily maintained, however, that

this Court held in *Central Greyhound* that straight mileage apportionment is an unquestionably fair method of apportioning receipts for purposes of a State's gross receipts tax. It is, therefore, a presumably fair method for apportioning net income for purposes of a State income tax. (The majority of other States, in fact, use it.)

It follows that every State other than Kentucky has the power to tax a portion of Liquid's net income equal to the mileage driven in that State. If each such other State does so tax, approximately 63 percent of Liquid's net income will be subject to tax by those other States.[14]

To allow Kentucky, in such circumstances, to tax approximately 79 percent of Liquid's net income is to violate the Commerce Clause.

III. Liquid Transporters, Inc. Did Not Waive Its Federal Constitutional Rights.

Upon its review of the entire record of this case, this Court will agree with the Kentucky Board of Tax Appeals that Liquid did not waive its federal constitutional rights by failing to petition the Revenue Cabinet for the use of an apportionment method different from Kentucky's unconstitutional apportionment system before filing its returns.

This Court has defined waiver as "an intentional relinquishment or abandonment of a known right or

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[14] As this Court has noted (334 U.S. at 663), the issue is the power of other States to tax, not the amount of tax actually collected by such other States.

privilege." *Barker* v. *Wingo,* 407 U.S. 514, 525-526 (1972). Courts should not presume acquiescence in the loss of fundamental rights. The rule applies in the context of property rights, as well as civil rights. See *Ohio Bell Telephone Co.* v. *Public Utilities Comm'n of Ohio,* 301 U.S. 292, 307 (1937).

Kentucky cannot establish a petitioning procedure which, if not satisfied, will require the payment of tax in excess of the amount allowed under the Due Process Clause and the Commerce Clause. When addressing the issue, the Court of Appeals of Kentucky has recognized this rule. *International Society for Krishna Consciousness* v. *Commonwealth, supra; Adkins* v. *Commonwealth, supra.*

This Court should not be deterred from taking this appeal because of the aberrant decision of the Jefferson Circuit Court below on the waiver issue. It is entirely unsupported by the record and all authorities.

CONCLUSION

For these reasons, this Court should note probable jurisdiction of the appeal.

Dated: April 10, 1987

Respectfully submitted,

JOSEPH L. T. ARDERY
BROWN, TODD & HEYBURN
1600 Citizens Plaza
Louisville, Kentucky 40202
502/589-5400

Counsel for Appellant
Liquid Transporters, Inc.

APPENDIX

APPENDIX A

COURT OF APPEALS OF KENTUCKY

No. 85-CA-1850-MR

721 S. W. 2d 722

LIQUID TRANSPORTERS, INC., - - - *Appellant,*

v.

REVENUE CABINET, Comonwealth of Kentucky, - - - - - - - *Appellee.*

REVENUE CABINET, Commonwealth of Kentucky, - - - - *Cross-Appellant,*

v.

LIQUID TRANSPORTERS, INC., - - *Cross-Appellee.*

November 7, 1986.

Discretionary Review Denied by Supreme Court January 13, 1987.

COOPER, Judge.

This is an appeal and cross-appeal from a judgment of the circuit court upholding a ruling of the Kentucky Board of Tax Appeals (hereinafter the Board). That ruling held that the statutorily prescribed method for apportioning business income subject to taxation for a corporation engaged in business within the Commonwealth was properly applied to the appellant. On direct appeal, the issue is whether the procedure set forth in the statute is an unconstitutional violation of both the Commerce and Due Process

Clauses of the United States Constitution. On cross-appeal, the issue is whether the circuit court acted correctly in ruling that the appellee's attempt to assess taxes for the 1973 year was effectively barred by the statute of limitations. KRS 141.210. Reviewing the record below, we affirm.

The essential facts giving rise to this litigation are as follows: In July of 1984, the Board affirmed a ruling issued by the appellee. Revenue Cabinet, Commonwealth of Kentucky, assessing additional taxes against the appellant, Liquid Transporters, Inc., for the years 1973-78. The assessment resulted from the appellee's following the procedure set forth in KRS 141.120(8), and the regulation promulgated under the statute, 103 KAR 16:120(2). Under authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission, the appellant is authorized to carry bulk commodities throughout Kentucky and neighboring jurisdictions. The appellant reported its income in the years in question on the basis of truck mileage traveled in Kentucky in proportion to its total truck mileage traveled throughout the United States. This basis for reporting income differed from that set forth in the statute and also the regulation. As a result, the Board affirmed the additional assessment issued by the Revenue Cabinet. This finding was affirmed by the circuit court.

The circuit court specifically found that the formula set forth in the statute and the regulation resulted in a *fair* assessment of corporate income tax owed by the appellant. Additionally, it found that the apportionment formula set forth in the statute did not violate the appellant's constitutional right of due process. And, it ruled that the appellant had waived its right to question the constitutionality of the apportionment and allocation formula set forth in the statute as a result of its failure to petition the ap-

pellee for an alternative method of taxation in the years in question. KRS 141.120(9). Finally, it ruled that the attempt by the Revenue Cabinet to assess additional taxes for 1973 would be barred by the statute of limitations. KRS 141.210. It is from such judgment that the appellant now appears and the appellee cross-appeals.

Initially, the appellant argues that the three-factor formula set forth in KRS 141.120 is, on its face, unconstitutional. Specifically, it argues that applying such a formula to the income it earned for the years in question resulted in an unfair and overlapping system of taxation with respect to the amount of corporate income tax it paid to sister states. Before addressing such issue, this Court notes that during the years in question, with the exception of 1971, the appellant failed to petition the Department of Revenue for an alternative method of taxation as provided for in KRS 141.120(9). That section states as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting;
>
> (b) The exclusion of any one or more of the factors;
>
> (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Only for the taxable year 1971 did the appellant make an attempt to file such a petition, which was simply attaching the petition to the back of the 1971 income tax return. Although it is arguable that this failure effectively estops the appellant from arguing that the method of allocation and apportionment utilized by the Cabinet is unconstitutional, we find it unnecessary to reach this issue, given our ruling that the statutory scheme is both fair and reasonable, and not in violation of either the Commerce or Due Process Clauses of the Constitution.

Under the statutory scheme set forth in KRS 141.120, three factors are utilized in determining the amount of business income taxable by the Commonwealth: the percentage of property owned and operated in Kentucky to total property owned and operated by the corporation in question; the percentage of payroll paid out of this state to the total payroll of the corporation; and the percentage of Kentucky sales to total sales. This percentage is divided by three and multiplied by the total business income in determining the amount subject to Kentucky taxation. In effect, three factors—that of payroll, property, and sales — are utilized in determining the amount of business income subject to Kentucky taxation rather than simply one factor, such as the amount of miles driven within the state in proportion to total mileage driven.

Although this three-factor formula has been upheld and approved by the Court in *Butler Brothers* v. *McColgan,* 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991 (1942), as well as in *Container Corporation of America* v. *Franchise Tax Bd.,* 463 U.S. 159, 103 S.Ct. 2933, 77 L. Ed. 2d 545 (1983), the appellant apparently argues that a one-factor formula, that of straight mileage apportionment, should be utilized. As authority for this argument it cites the decision of the Court in *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S.

653, 68 S.Ct. 1260, 92 L.Ed. 1633 (1947). We find *Central Greyhound* distinguishable. In effect, that Court ruled that the method for appropriating income to a state must be a fair method. By no means did it mandate a straight mileage method of apportionment. Rather, the Court ruled that under the existing taxing scheme of New York, an unapportioned gross receipt tax levied on an interstate business violated the Commerce Clause.

In *Container Corp., supra,* the Court endorsed the three-factor formula and stated that an indication of its fairness in a specific context is whether it exhibits internal and external consistency. By internal consistency, the Court stated that if such method were applied in every jurisdiction, it would result in no more than all the taxpayer's business income being taxed. Here, the appellant has failed to demonstrate that if the statutory scheme set forth in the statute were employed in all jurisdictions, more than a hundred percent of the taxpayer's business income would be taxed. Furthermore, as that Court stated: "a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States. . . ." at p. 557. And, it held that only a constituted mandated method of taxation could eliminate all overlapping taxation.

Besides affirming that an apportionment formula should possess internal consistency, the *Container Corp., supra,* Court held that it must possess an external consistency, a characteristic difficult to define. Specifically, the Court stated as follows:

> [T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not

> have its source in the taxing State . . . Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted in that State'." *Id.* at p. 556.

Reviewing the record before this Court, we do not believe that the appellant has presented clear and cogent evidence that the business income generated by it and attributed to this Commonwealth is, in fact, "out of all appropriate proportion to the business transacted" within this state. Although the appellant argues that most of its revenue results from interstate travel in states other than Kentucky, the record reflects the fact that the appellant has its corporate headquarters and corporate domicile in this jurisdiction and both owns and leases real property here. Furthermore, it benefits from workers' compensation and unemployment insurance laws, and most of its bulk shipments originate from this state. Taken as a whole, we find that the evidence was substantial and supported the finding of both the Revenue Cabinet and the circuit court. As such, it will be upheld on appeal.

Finally, on cross-appeal, we concur with the findings of fact of the circuit court that the statute of limitations barred the assessment for the year 1973. In addressing such issue, the circuit court stated in its judgment the following:

"The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

> 1. As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer,

the excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided . . . a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be asserted at any time within six years after the return was filed.

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable" to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitations when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes."

We concur with the court's ruling.

The judgment of the circuit court is affirmed.

All concur.

APPENDIX B

SUPREME COURT OF KENTUCKY

86-SC-994-D

(85-CA-1850-MR & 85-CA-2598-MR)

LIQUID TRANSPORTERS, INC. - - - - *Movant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Respondent*

Jefferson Circuit Court
No. 84-CI-06717

ORDER DENYING DISCRETIONARY REVIEW

The motion of the movant for a review of the decision of the Court of Appeals is denied.

ENTERED January 13, 1987.

(s) Robert F. Stephens
Chief Justice

APPENDIX C

JEFFERSON CIRCUIT COURT

TWELFTH DIVISION

No. 84CI 06717

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

JUDGMENT AFFIRMING AND REVERSING IN PART MEMORANDUM OPINION

On July 25, 1984, the Kentucky Board of Tax Appeals affirmed the assessment against Liquid Transporters of additional Kentucky corporation income taxes for the years 1973 through 1978. Liquid Transporters appeals.

Appellant is represented by the Honorable Joseph L.T. Ardery and the appellee is represented by the Honorable Ross Carter. Both parties have filed exhaustive briefs and have orally argued this case on March 1, 1985.

In appeals pursuant to KRS 133.370, this Court is limited in scope. Under the statute, these actions are disposed of in a summary manner and the review is limited to determining whether or not:

"(a) The Board acted without or in excess of its powers;

(b) The Order, Decision or Award was procured by fraud;

(c) The Order, Decision or Award is not in conformity to the law;

(d) The Findings of Fact are an issue whether such Findings of Fact Support the Order, Decision or Award."

If the Findings of Fact are supported by substantial evidence and if the assessment conforms to the law, then the Decision must be affirmed. (*Trimble County Board of Supervisors* v. *Mullikin,* Ky., 438 S. W. 2d 524 (1968); *Department of Revenue* v. *Anaconda American Brass Company,* Ky., 435 S. W. 2d 65 (1968).

The appellant, Liquid Transporters, Inc. (hereinafter referred to as Transporters) carry bulk commodities by authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission. From 1973 through 1978, Transporters reported its income to the State of Kentucky based upon its truck miles traveled in Kentucky as compared to its total miles traveled everywhere. The Department of Revenue found a deficiency for each of the years using the formula promulgated in regulation. (103 KAR 16:120(2)). Transporters makes the following arguments:

1. The Kentucky Allocation and Apportionment Formula does not fairly apportion the income of Transporters subject to the tax.
2. The Kentucky apportionment method violates the due process rights of Transporters.
3. The appellant did not waive its constitutional rights by failing to properly petition for the use of the straight mileage apportionment.
4. The 1973 assessment against Transporters is barred by the Statute of Limitations.

These arguments are addressed separately.

I. THE KENTUCKY ALLOCATION AND APPORTIONMENT FORMULA FAIRLY APPORTIONS THE INCOME OF APPELLANT SUBJECT TO KENTUCKY INCOME TAX.

Transporters argues that the Board should have followed the case of *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S. 653, 92 L.Ed. 1633 (1947). They contend that this case holds that the taxing scheme set up by the State be struck down by the Court.

Although Transporters cites certain phrases from the case, the ruling does not support the contention that the apportionment formula is improper. In Central Greyhound, a trucking company was taxed on its "gross receipts" where the trucks drove not only in New York but also in Pennsylvania and New Jersey. The Court held that New York cannot tax the company on 100% of the "gross receipts" when only 57.47% of the mileage was driven in New York. The tax must be "fairly apportioned" to the business done within the State by a "fair method of apportionment".

This case in no way holds that the straight mileage formula is *required* or that Kentucky's formula is not fair just because it is not based solely on mileage. The tax is fairly apportioned to the business done within the State. (*Container Corporation of America* v. *Franchise Tax Board,* 103 S.Ct. 2933 (1983)), 77 L. Ed. 2d 545; *Moorman Manufacturing Company* v. *Bair,* 98 S.Ct. 2340 (1978)).

The Container and Moorman cases uphold either single or multiple factor formulas used for apportionments. The Container case even proclaims that the constitution imposes no single formula in the States. The formula must be fair and externally consistent. The three-factor formula based in equal parts as to payroll, sales and property has been approved.

II. KENTUCKY'S APPORTIONMENT METHOD DOES NOT VIOLATE THE DUE PROCESS RIGHTS OF TRANSPORTERS.

The facts found in this case not only show that Transporters traveled 40% of all of its miles in Kentucky, but it has its corporate headquarters and commercial domicile here. It owns and leases real property here. It benefits from the Worker's Compensation and Unemployment Insurance laws of this State. It does all its dispatching and most of its shipping from Kentucky. It solicits business within the State. It has bank accounts, accountants, and numerous other contacts within the Commonwealth of Kentucky, which it does not have with other States. In *Moorman Manufacturing Company* v. *Bair, supra,* the Court handed down two restrictions to states taxing interstate commerce done within the individual state in order to meet the due process requirements of the Fourteenth Amendment of the U.S. Constitution. The restrictions were that:

1) No tax would be imposed, unless there is some minimal connection between those activities and the taxing state.
2) The income attributed to the state for tax purposes must be rationally related to values connected with the taxing state.

The Commonwealth's three-factor formula satisfies the above restrictions and fairly measures the income generated by appellant's business activities in this State. The formula which is applied for determining Transporters' income is basically as follows, to-wit:

$$\frac{\text{Kentucky Property}}{\text{All Property}} \text{ plus } \frac{\text{Kentucky Payroll}}{\text{All Payroll}} \text{ plus } \frac{\text{Kentucky Sales}}{\text{All Sales}}$$

Divide the sum by three and the result is equal to total "taxable" business income.

KRS 141.120(10(d) is a promulgating authority for development of regulations which were adopted by the Revenue Cabinet. The regulations provide that the sales factor would be determined by mileage driven in Kentucky divided by mileage driven everywhere. (103 KAR 16; 120(2)). The property factor would be determined by the value of all over-the-road equipment excluded from the computation. Transporters contends that this exclusion is unfair. However, if it were included, then logically it must be assigned mileage since a good portion of the over-the-road equipment is used outside the State and inclusion of the over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. It is also noted that mileage is already considered in a third of the formula's makeup.

The Court cannot conclude that the three-factor formula which fairly takes into account Transporters nexus and relationships with the Commonwealth is unfair. It is also noted that the burden is on the party seeking to use some other method to show that the formula distorts or is unfair. (KRS 141.120(9); *Ruby Construction Company* v. *Revenue,* Ky. App., 578 S.W. 2d 248 (1979)). This has not been done and the Court concludes that the apportionment method does not violate Transporters due process rights.

III. BY FAILING TO PETITION IN ACCORDANCE WITH 141.120(9) FOR THE YEARS IN QUESTION, TRANSPORTERS HAS WAIVED ITS RIGHT TO QUESTION THE APPLICATION OF THE THREE-FACTOR FORMULA.

The Revenue Department argues that while the appellant has the right to petition for relief under KRS 141.120 (9), it waived that right by failing to file the proper petition. This, it contends, is a condition precedent in order to take advantage of KRS 141.120(9) and thus these rights were waived. (28 Am. Jur. 2d, Estoppel & Waiver, Sec. 164).

The provisions of Section 9 of KRS 141.120 provide as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this State, taxpayer may petition for or the department may require in respect to all or any part of the taxpayer's business activity if reasonable (a) separate accounting (b) the exclusion of any one or more of the factors (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

It is undisputed that Transporters did not petition the Department pursuant to this particular section for any of the years in question.

Transporters, without complying with this "relief" section, cannot now be heard to come forward and some five years later complain about the allocation formula. In this respect also, the Court believes that the Decision of the

Board of Tax Appeals is in conformity with the law. (KRS 141.120(9)).

IV. THE 1973 ASSESSMENT SHOULD BE BARRED BY THE STATUTE OF LIMITATIONS

Transporters filed its corporate income tax return for 1973 on March 15, 1974. Kentucky assessed additional tax with respect to 1973 on August 1, 1979. This was a period in excess of four years after the filing date.

The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

1. "As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer, the excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided. . . .

   a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be assessed at any time within six years after the return was filed".

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable"

to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitation when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes.

JUDGMENT

For the reasons set forth hereinafter in the Memorandum Opinion, it appearing that there is substantial evidence to support the Findings of Fact and Conclusions of Law and the ruling of the Kentucky Board of Tax Appeals and further that the Board did not err as to the assessment of the 1973 tax and the Court being further advised, the Decision of the Kentucky Board of Appeals is affirmed in part and reversed in part as it applies to the 1973 assessment. This is a final Order.

(s) Edwin Schroering, Jr.
Edwin A. Schroering, Jr., Judge

Date May 23, 1985

Copy To:

Joseph L.T. Ardery
Ross Carter

APPENDIX D

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - - *Appellee*

OPINION

This appeal is from a final ruling of the Kentucky Revenue Cabinet where the appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978. During the years in question the appellant reported its income to Kentucky based upon its miles (truck) in Kentucky against its total miles everywhere. However, the Cabinet, in its audit, used a three factor formula to determine their income. This formula is based on mileage in Kentucky, as compared to total mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

The appellant contends that the application of the Cabinet's apportionment method is unfair and:

1. Violates the Due Process rights of appellant;
2. Violates the Commerce Clause rights of appellant;
3. Violates legislative intent of The Uniform Division of Income for Tax Purposes Act (UDOTPA) (KRS 141.120.

The appellant also claims that the Cabinet's assessment as to 1973 is barred by the statute of limitations.

Appellee argues that the appellant has waived its right to question the three factor formula by failing to petition for a different apportionment formula in accordance with KRS 141.120(9); and argues, of course, that the three factor formula is constitutional and fair.

This Board agrees that appellee failed to properly petition for the use of a different apportionment formula under KRS 141.120(9). However, the Board does not agree that appellant waived its right to question the application of the three factor formula.

On the primary issue, this Board is of the opinion that the three factor formula used by the Cabinet does fairly measure the income generated by appellant's business activities in Kentucky. The recent Supreme Court Case, *Container Corporation of America* v. *Franchise Tax Board,* answers and puts to rest the constitutional arguments made by this appellant.

Finally, the Board agrees with appellee on the Statute of Limitations questions. The six year statute of limitation clearly applies in this case. Therefore, the 1973 tax year will remain in the assessment.

Counsel for the appellee are directed to prepare proposed findings of fact, conclusions of law, and proposed order pursuant to this opinion for consideration by the Board within 30 days from the date of this opinion, with copy to be served upon appellee's counsel for comment within 15 days thereafter, It is clearly understood that the Board will prepare its own findings of fact and conclusions of law after the proposed findings and conclusions and comments thereto have been submitted.

This 9th day of April, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - - *Appellee*

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Order No. K-10305

FINDINGS OF FACT

1. This appeal is from a final ruling of the Kentucky Revenue Cabinet where the Appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978.

2. The Appellant, Liquid Transporters, Inc., is in the business of transporting bulk commodities through authorities granted it by the Interstate Commerce Commission and the Kentucky Public Utilities Commission. During the years in question the Appellant reported its income to Kentucky based upon its miles (truck) in Kentucky against its total miles everywhere. Appellee, in its audit, used the three factor formula prescribed by statute and regulation to determine their income. This formula is based on mileage in Kentucky, as to total mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

3. The Appellant's method of determining its tax liability to the State of Kentucky does not reflect the full extent of its business activities in this state.

Forty percent of Appellant's miles occur in Kentucky. It has its corporate headquarters and commercial domicile here in Kentucky. It owns and leases real property here. It operates under the worker's compensation and unemployment insurance laws of this state. All dispatching is done from Kentucky. Most of its shipments originate from this state. It solicits its business from this state. It has its bank accounts and accountants in this state.

4. The three factor formula utilized by the Revenue Cabinet fairly measures the income generated by Appellant's business activities in the State of Kentucky.

5. Under the statute, KRS 141.120, a taxpayer may petition for use of some alternative to the statutory three factor formula. During the years in issue the Appellant made no such petition.

6. For the years 1973 the Appellant understated its taxable net income for Kentucky by more than 25%.

7. While the Kentucky legislature directed that the three factor formula should be applied to public service companies, it specifically directed that the Revenue Cabinet should develop regulations with respect to the determination of the property factor and the sales factor. KRS 141.120(10)(d). The regulations which were promulgated for trucking companies provided that the sales factor would be determined by mileage driven in the state divided by mileage driven everywhere. 103 KAR 16:120(2). The regulation also provides that the property factor will be determined by the value of the Kentucky property divided by the value of all property with the value of all over-the-road equipment excluded from the computation. 103 KAR 16:120(3).

8. There is some testimony that it was at the request of the trucking industry that over-the-road equipment was excluded from the property computation.

9. The primary rationale for excluding over-the-road equipment from the property factor is that, since this type of property must be assigned by mileage, inclusion of over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. Mileage, already makes up a full third of the formula through its use as the determining element in the sales factor.

10. In this case, it would be difficult to value Appellant's leased over-the-road equipment. This is because the leases in question include elements which are not properly attributable to the value of the leased equipment. For instance, in its typical lease, Liquid Transporters was paying not only for the property leased, but for a driver, insurance, repair and maintenance, fuel, oil, tires, batteries. tolls, taxes, licenses, substitute equipment, and other operating necessities for the equipment. If these leases were capitalized at eight times their value (the stautory method of capitalization) a gross distortion in the property factor would result.

11. By applying a three factor formula in which a full third of the formula is based on mileage and which fairly takes into account the taxpayer's property and payroll in the state and outside the state, Kentucky has arrived at a fair and reasonable income allocation and apportionment method which reflects the extent of Appellant's business activity in Kentucky.

CONCLUSIONS OF LAW

The burden of proof is upon the party seeking to vary from the statutory formula. *Ruby Construction Co., Inc.*

v. *Revenue,* Ky. App., 578 S.W.2d 248 (1979). The Appellant here has not carried its burden.

Since the three factor statutory formula fairly apportions the income of Appellant subject to Kentucky income tax, the assessment must be upheld and the Cabinet's final ruling affirmed.

Appellant's returns understated its taxable net income by more than 25%. Therefore the six year statute of limitations applies pursuant to KRS 141.210, and the assessment for the year 1973 is proper.

This 25th day of July, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

APPENDIX E

IN THE

COURT OF APPEALS OF KENTUCKY

No. 85-CA-1850-MR

LIQUID TRANSPORTERS, INC. - - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - - *Appellee*

(Marked filed by Court Clerk March 31, 1987)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Liquid Transporters, Inc., the appellant named above, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeals of the Commonwealth of Kentucky on the federal constitutional issues raised by Liquid Transporters, Inc., which was entered November 7, 1986, and discretionary review of which was denied by the Supreme Court of Kentucky by its order entered January 13, 1987.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

(s) Joseph L. Ardery
Joseph L. Ardery
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1600 Citizens Plaza
Louisville, Kentucky 40202
502/589-5400
Counsel for Appellant

APPENDIX F

KRS 141.120 Division of Income of Interstate Business for Tax Purposes.

(1) As used in this section, unless the context requires otherwise:

(a) "Business income" means income arising from transactions and activity in the regular course of a trade or business of the taxpayer and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations;

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is managed;

(c) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or payable to employees for personal services;

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank investment company, or any type of insurance company;

(e) "Nonbusiness income" means all income other than business income;

(f) "Public service company" means any business entity subject to taxation under KRS 136.120;

(g) "Sales" means all gross receipts of the taxpayer not allocated under subsections (3) through (7) of this section;

(h) "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(2) Any corporation which is required by KRS 141.010 (14)(b) to allocate and apportion its net income shall allocate and apportion its net income as provided in this section.

(3) Rents and royalties from real or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsections (4) through (7) of this section.

(4) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible property are allocable to this state if and to the extent that the property is utilized in this state; or in their entirety if the taxpayer's commercial domicile is in this state and the taypayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period of the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personalty is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(5) (a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if the property had a situs in this state at the time of sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(6) Interest is allocable to this state if the taxpayer's commercial domicile is in this state.

(7) (a) Patent and copyright royalties are allocable to this state in and to the extent that the patent or copyright is utilized by the payer in this state; or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or of the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized to the extent that printing or other publication originates in the state. If the basis of receipts from copyright does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(8) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor

plus the sales factor, and the denominator of which is three (3).

(a) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals, provided that such rental and such sub-rentals are reasonable. If the department determines that the annual rental or sub-rental rate is unreasonable, or if a nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value of the property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(b) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and

the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the state from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed

in this state than in any other state, based on costs of performance.

(9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(10) Public service companies and financial organization required by KRS 141.010(14)(b) to allocate and apportion net income shall allocate and apportion such income as follows:

(a) Nonbusiness income shall be allocated to this state as provided in subsections (4) through (7) of this section;

(b) Business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three (3). The payroll factor shall be determined as provided in subsection (8) (b) of this section. The property factor and sales factor shall be determined as provided by regulations promulgated by the department.

APPENDIX G

103 KAR 16:090. Apportionment; payroll factor.

RELATES TO: KRS 141.120

PURSUANT TO: KRS Chapter 13a

NECESSITY AND FUNCTION: KRS 141.120(8) requires that all business income of multi-state corporations be apportioned to Kentucky by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three (3). This regulation provides a detailed explanation of the payroll apportionment factor.

Section 1. General. (1) The payroll factor shall include the total amount paid by the corporation for compensation during the taxable year.

(2) The total amount "paid" to employees is determined by the corporation's accounting method. If the corporation has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the corporation's method of accounting, compensation paid to employees may be included in the payroll factor by the cash method if the corporation is required to report compensation under such method for unemployment compensation purposes. The corporation shall be consistent in the treatment of compensation paid in filing returns or reports to all states. If the corporation is not consistent in its reporting, it shall disclose in its Kentucky return the nature and extent of the inconsistency.

Section 2. Compensation. (1) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are

excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the corporation in return for personal services provided that such amounts constitute income to the recipient under the Federal Internal Revenue Code. In the case of employees not subject to the Federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the Federal Internal Revenue Code.

(2) The payroll factor includes only compensation which is attributable to business income subject to apportionment. The compensation of any employee whose activities are connected primarily with nonbusiness income shall be excluded from the factor.

(a) Example: The corporation uses some of its employees in constructing a storage building which will be used for production of business income. The wages paid to those employees is treated as a capital expenditure. The amount of such wages is included in the payroll factor.

(b) Example: The corporation owns various securities from which nonbusiness income is derived. The management of the investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

Section 3. Employee. The term "employee" means:

(1) Any officer of a corporation, or

(2) Any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered an employee if he is included by the corporation as an employee for purposes of the payroll

taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

Section 4. Payroll Factor-Numerator. (1) The numerator of the payroll factor is the total amount paid in Kentucky during the taxable year by the corporation for compensation. The tests in KRS 141.120(8)(b), to be applied in determining whether compensation is paid in Kentucky are derived from the model unemployment compensation act. Accordingly, if compensation paid to employees is included in the payroll factor by the cash method of accounting, or if the corporation is required to report compensation under such method for unemployment compensation purposes, it shall be presumed that the total wages reported by the corporation to Kentucky for unemployment compensation purposes constitutes compensation paid in Kentucky except for compensation excluded by this regulation. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to Kentucky for unemployment compensation purposes.

(2) Compensation is paid in Kentucky if any one of the following tests, applied consecutively, are met:

(a) The employee's service is performed entirely within Kentucky.

(b) The employee's service is performed both within and without Kentucky, but the service performed without Kentucky is incidental to the employee's service in Kentucky. The word "incidental" means any service which is

temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(c) If the employee's services are performed both within and without Kentucky, the employee's compensation will be attributed to Kentucky:

1. If the employee's base of operations is in Kentucky; or

2. If there is no base of operations in any state in which some part of the service is performed but the place from which the service is directed or controlled is in Kentucky; or

3. If the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in Kentucky.

(3) The term "base of operation" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the corporation or communications from his customers or other persons, or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.

(4) The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the corporation.

Section 5. Payroll Factor-Denominator. (1) The denominator of the payroll factor is the total compensation paid everywhere during the taxable year. Accordingly, compensation paid to employees whose services are performed entirely in a state where the corporation is exempt from taxation, for example, by Public Law 86-272, are included in the denominator of the payroll factor.

(2) Example: A corporation, has employees in its state of legal domicile (State A) and is taxable in State B. In addition the corporation has other employees whose services are performed entirely in State C where the corporation is exempt from taxation by Public Law 86-272. The compensation paid employees in State C will be assigned to State C where their services are performed (i.e. included in the denominator only of the payroll factor) even though the corporation is not taxable in State C. (IC-9; 1 Ky. R. 143; eff. 12-11-74).

APPENDIX H

103 KAR 16:120. Apportionment and allocation; trucklines, bus lines; airlines.

RELATES TO: KRS 141.120

PURSUANT TO: KRS Chapter 13a

NECESSITY AND FUNCTION: This regulation, under authority of KRS 141.120(10)(b), specifies how the factors for apportioning the income of interstate truckline, bus line, and airline companies are to be determined.

Section 1. General. (1) Business income of multi-state corporate truckline, bus line, or airline, shall be apportioned to Kentucky by multiplying the income by a fraction, the numerator of which is the sales factor plus the property factor plus the payroll factor, and the denominator of which is three (3).

(2) Nonbusiness income shall be allocated to Kentucky by KRS 141.120(3) to (7) and 103 KAR 16:060.

Section 2. Sales Factor. "Sales" means operating income as defined by the Interstate Commerce Commission (Civil Aeronautics Board for airlines). The sales factor is a fraction, the numerator of which is operating income assigned to Kentucky and the denominator of which is total operating income. Kentucky operating income is determined as follows: Total operating income shall be multiplied by a fraction the numerator of which is miles in Kentucky and the denominator of which is total miles operated.

Section 3. Property Factor. The property factor is a fraction, the numerator of which is the average value of tangible property sitused in Kentucky that is owned and used, and/or leased and used. The denominator is the average value of all tangible sitused property that is owned and used and/or leased and used. The average value of

tangible situsued property during the tax period shall be determined under the provisions of 103 KAR 16:080. The value of over-the-road equipment and of aircraft shall be excluded in determining the average value of both Kentucky and total property.

Section 4. Payroll Factor. The payroll factor shall be determined under the provisions of KRS 141.120(8)(b) and 103 KAR 16:090. (IC-12; 1 Ky. R. 224; eff. 1-8-75.)

APPENDIX I

AS SUBMITTED TO BOARD OF TAX APPEALS

APPORTIONMENT METHODS OF 48 STATES

State	State Income Tax	Method of Apportionment
Alabama	Yes	A
Arizona	Yes	A
Arkansas	Yes	A
California	No	
Colorado	Yes	A
Connecticut	Yes	B
Delaware	Yes	A
Florida	Yes	A
Georgia	Yes	A
Idaho	Yes	B
Illinois	Yes	A
Indiana	Yes	B
Iowa	Yes	A
Kansas	Yes	A
Kentucky	Yes	C
Louisiana	Yes	B
Maine	Yes	A
Maryland	Yes	B
Massachusetts	D	A
Michigan	No	
Minnesota	Yes	A
Mississippi	Yes	A
Missouri	Yes	A
Montana	Yes	A
Nebraska	Yes	B
Nevada	No	
New Hampshire	No	
New Jersey	Yes	A
New Mexico	Yes	B
New York	Yes	A
North Carolina	Yes	A
North Dakota	Yes	B

APPORTIONMENT METHODS OF 48 STATES

State	State Income Tax	Method of Apportionment
Ohio	Yes	B
Oklahoma	Yes	B
Oregon	Yes	B
Pennsylvania	Yes	A
Rhode Island	Yes	B
South Carolina	Yes	A
South Dakota	No	
Tennessee	D	A
Texas	No	
Utah	Yes	A
Vermont	Yes	A
Virginia	Yes	A
Washington	No	
West Virginia	Yes	A
Wisconsin	Yes	A
Wyoming	No	

A. Total Miles traveled within state as compared to total Miles.

B. Three factor apportionment based on:

Property—All real and personal property within state (except tractors and trailers which are based on miles traveled within state as compared to total miles) as compared to total property everywhere.

Payroll—All wages of employees working within the state (except drivers' wages which are based on miles traveled within the state as compared to total miles) as compared to total wages everywhere.

Revenue—All revenue based on total miles traveled within state as compared with total miles traveled everywhere.

C. Kentucky assessment

D. Tennessee excise (income) tax
Massachusetts excise (income) tax

Supreme Court, U.S.
FILED
MAY 9 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1652

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - Appellant

versus

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - Appellee

On Appeal from the Court of Appeals of Kentucky

MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

1. Has Liquid Transporters failed to show that the decision was not or could not be decided on an adequate non-federal basis?

2. Has Liquid Transporters failed to present before this Court grounds to show a substantial question of constitutional law?

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No. 86-1652

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - - *Appellant*

v.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - *Appellee*

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

MOTION TO DISMISS OR AFFIRM

The Appellee, Revenue Cabinet, Commonwealth of Kentucky, respectfully moves to dismiss the appeal herein or in the alternative to affirm the judgment of the Court of Appeals of Kentucky on the ground that it is manifest that the questions upon which the decision of the cause depends are so insubstantial as not to need further argument.

I. THE STATE LAW INVOLVED AND THE NATURE OF THE CASE.

A. The Relevant Statutes And Regulations.

This appeal questions the constitutionality of Section 141.120 of the Kentucky Revised Statutes and Kentucky Administrative Regulations as set forth in

103 Kentucky Administrative Regulation 16:090 and 103 Kentucky Administrative Regulation 16:120.

Kentucky Revised Statute 141.120 provides the methodology by which multi-state corporations pay income tax for business activities carried on in the state of Kentucky. (Appendix A.) The provisions of Kentucky Revised Statute 141.120 were adopted by the Kentucky legislature in 1966 from the Uniform Division of Income for Tax Purposes Act ("UDIPTA"). The provisions of Kentucky Revised Statute 141.120 require that the factors of payroll, property and sales be used in a three-factor formula to determine corporate income subject to Kentucky tax.

The legislature, in enacting the three-factor UDIPTA formula, recognized the uniqueness of a public service company's business. The legislature made provision for the Revenue Cabinet to define, by regulation, the sales and property factors as applied to a public service company. Kentucky Revised Statute 141.120 (10)(b). The Revenue Cabinet did promulgate regulations for public service companies. At the time the Revenue Cabinet promulgated these regulations, special provisions defining the three factors were enacted for trucklines, buslines and airlines. 103 Kentucky Administrative Regulation 16:120. (Appendix B.)

As a public service company in the trucking business, Liquid Transporters' income was apportioned pursuant to the three-factor UDIPTA formula, with the three factors defined as set forth in 103 Kentucky Administrative Regulation 16:120. The three-factor

formula as defined for trucklines was applied to Liquid Transporters as follows:

$$\text{Kentucky Business Income} = \frac{\text{Kentucky Property}}{\text{All Property}} + \frac{\text{Kentucky Payroll}}{\text{All Payroll}} + \frac{\text{Kentucky Sales}}{\text{All Sales}} \times \text{Total Business Income}$$

Liquid Transporters argues that the application of the three-factor formula results in an abnormally high percentage factor. When this percentage factor is added to the factors applied in other states where corporate income tax is paid, Liquid Transporters contends that it resulted, for several years of the audit period, in a factor exceeding one hundred percent. Liquid Transporters claims that this use of the three-factor formula in Kentucky violates its rights under the Due Process and Commerce Clauses because of the resulting high percentage factor. Liquid Transporters further argues that, as a matter of law, Kentucky is required to apply a formula in conformity with formulas used in other states. Liquid Transporters argues that the "uniqueness" of the Kentucky formula makes it violative of the Due Process and Commerce Clauses of the federal constitution.

B. The Proceeding Below.

The Revenue Cabinet audited Liquid Transporters for the years 1973 through 1978. In assessing a corporate income tax deficiency, the Revenue Cabinet applied the three-factor UDIPTA formula as defined in 103 Kentucky Administrative Regulation 16:120.

Liquid Transporters alleged that it had petitioned the Revenue Cabinet for a modification of the formula pursuant to Kentucky Revised Statute 141.120(9) by attaching a copy of its alternate formula to its 1971 income tax return. This formula used a single factor: mileage in Kentucky as the numerator and all mileage as the denominator. For the years of 1973 through 1978, Liquid Transporters paid corporate income tax based upon the use of the single factor formula. Liquid Transporters contested the Revenue Cabinet's assessment and filed an action with the Kentucky Board of Tax Appeals ("Board"). The Board, in upholding the income tax assessment, ruled on July 23, 1984, that Liquid Transporters had failed to properly petition the Revenue Cabinet for a modification of the three-factor formula and that Liquid Transporters had failed to meet the requisite burden of proof to show that the formula used by the Revenue Cabinet did not fairly measure income generated by Liquid Transporters in Kentucky. (Appendix C.) Liquid Transporters appealed the Board's decision to the Jefferson County, Kentucky, Circuit Court. The Jefferson Circuit Court affirmed the decision of the Board in a decision dated May 23, 1985. (Appendix D.) The decision was appealed to the Court of Appeals of the State of Kentucky. In an order dated November 7, 1986, the decision was affirmed. 721 S. W. 2d 722 (1986). (Appendix E.) A motion for discretionary review, filed by Liquid Transporters with the Supreme Court of Kentucky, was denied in an order dated January 13, 1987. (Appendix F.)

II. ARGUMENTS

1. No Right of Review by the Court Will Be Granted When the Case at Issue Was or Could Be Decided on an Adequate, Non-Federal Basis.

Kentucky Revised Statute 141.120(9) requires that a corporation objecting to the use of the three-factor formula file a petition with the Revenue Cabinet to request an alternative method be used to apportion corporate business income. The petitioning corporation must show the following:

> 1) that the three-factor formula does not fairly reflect income generated by the corporation in the State of Kentucky; and
>
> 2) that a proposed alternate formula proferred by the corporation fairly reflects the income generated by his business activities in Kentucky.

The Board correctly ruled from the evidence before it that Liquid Transporters had waived its right to use an alternate formula as it had failed to properly petition the Revenue Cabinet for a modification of the formula. This ruling was affirmed by the Jefferson Circuit Court. While the Court of Appeals did not affirm the Board's decision on this issue, the Court did agree that Liquid Transporters had failed to properly petition the Revenue Cabinet.[1]

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[1]The Court stated: "Initially, the appellant argues that the three-factor formula set forth in KRS 141.120 is, on its face, unconstitutional. . . . Before addressing such issue, this Court notes that during the years in question, with the exception of 1971, the appellant failed to petition the Department of Revenue for an al-

(Footnote Continued on Next Page)

No right of review lies where a case was or could have been decided on an adequate, non-federal basis. *Jean* v. *Nelson,* 105 S. Ct. 2992 (1985). Despite the language in the Court of Appeal's decision this case could have been decided purely on procedural grounds. Liquid Transporters has failed to take advantage of procedural relief granted by state statute and cannot assert sufficient standing to sustain this appeal.

2. This Case Presents No Substantial Federal Question Not Previously Decided by This Court.

It is a well-established legal maxim that the state has the authority to tax the multi-state corporation if that corporation has sufficient contacts or nexus with the taxing state. *Wisconsin* v. *J. C. Penney Company,* 311 U. S. 435 (1940). The right to tax arises from the sovereign powers granted the states by the Constitution of the United States. *M'Culloch* v. *Maryland,* 17 U. S. (4 Wheat.) 316 (1819). This is not to say that constitutionally there are no guidelines associated with the state's right to tax a multi-state corporation. The method or manner of assessing tax must, under

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(Footnote Continued From Preceding Page)

ternative method of taxation as provided for in KRS 141.120(9). . . . Only for the taxable year 1971 did the appellant make an attempt to file such a petition, which was simply attaching the petition to the back of the 1971 income tax return. Although it is arguable that this failure effectively estops the appelant from arguing that the method of allocation and aportionment utilized by the Cabinet is unconstitutional, we find it unnecessary to reach this issue, given our ruling that the statutory scheme is both fair and reasonable, and not in violation of either the Commerce or Due Process Clauses of the Constitution." (721 S. W. 2d at 724).

both the Due Process Clause and the Comerce Clause, be fair. *Container Corporation of America* v. *Franchise Tax Board*, 463 U. S. 159, 169 (1983); *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U. S. 653, 663 (1948). These constitutional parameters have been interpreted to require the state to apportion income to fairly reflect the business activities carried on and the benefits received from the taxing state. *Container, supra; Central Greyhound, supra.* The UDIPTA formula and the three-factor formula have been recognized by this Court as meeting the fairness criteria. *Container, supra; Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123 (1931). While recognizing the merits of the UDIPTA formula, this Court has not dictated that it is the only fair method available to the states to apportion corporate income subject to tax. *Container, supra.* There is no requirement that a state's method of assessing corporate income subject to tax on the multi-state corporation be uniform. *Container, supra,* at 171; *Moorman Manufacturing Co.* v. *G. D. Bair*, 437 U. S. 267, 274 (1978); *Wisconsin* v. *J.C. Penney, supra.* There is also no prohibition against a state using a factor or factors which cumulatively result in the corporation having a percentage factor used to apportion income that exceeds one hundred percent. *Moorman, supra,* at 278. The Court, however, has mandated that if all states applied the same formula to apportion corporate income, the percentage factor applied to a corporation's income cannot exceed one hundred percent. *Moorman, supra,* at 267. If all states applied the Kentucky three-factor

UDIPTA formula to multi-state trucklines, the percentage factor would not exceed one hundred percent.

Liquid Transporters has incorrectly cited *Greyhound, supra,* in support of its contention that Kentucky must use the single factor of mileage to apportion income. It was held in *Greyhound, supra,* that the single mileage factor was appropriate. However, the court in *Greyhound, supra,* did not rule that the mileage factor was the only method individual states could use to apportion income.

This Court has previously resolved the issue asserted by Liquid Transporters. This Court has repeatedly acknowledged the right of a state to determine the method of apportioning income. The Court of Appeals of the State of Kentucky has affirmed the use of the UDIPTA three factor formula as modified for trucklines on the basis that the formula fairly reflected Liquid Transporers' business activities in Kentucky. The fact that the UDIPTA formula applied to trucklines fairly reflects business activities carried on in the state of Kentucky presents no substantial federal question.

III. CONCLUSION

Wherefore, the Revenue Cabinet, as appellee, respectfully submits that the questions upon which this case depends 1) can be decided on adequate non-federal grounds and 2) are so insubstantial that they need no further argument, and appellee respectfully moves this Court to dismiss this appeal, or in the alternative, to affirm the judgment entered in the cause by the Court of Appeals of Kentucky.

Respectfully submitted,

CELIA M. DUNLAP
Counsel for Appellee
Revenue Cabinet
Commonwealth of Kentucky

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Motion of Appellee to Dismiss or Affirm were served this 8th day of May, 1987, in compliance with the Rules of the Supreme Court of the United States, by depositing three copies in a United States post office box or mailbox, with first-class postage prepaid, addressed to Hon. Joseph L. T. Ardery, Brown, Todd & Heyburn, 1600 Citizens Plaza, Louisville, Kentucky 40202. All parties required to be served have been served.

Celia M. Dunlap

CELIA M. DUNLAP

Attorney for Appellee,
Revenue Cabinet
Commonwealth of Kentucky

APPENDIX

APPENDIX A

KRS 141.120 Division of Income of Interstate Business for Tax Purposes.

(1) As used in this section, unless the context requires otherwise:

(a) "Business income" means income arising from transactions and activity in the regular course of a trade or business of the taxpayer and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations;

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is managed;

(c) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or payable to employees for personal services;

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank investment company, or any type of insurance company;

(e) "Nonbusiness income" means all income other than business income;

(f) "Public service company" means any business entity subject to taxation under KRS 136.120;

(g) "Sales" means all gross receipts of the taxpayer not allocated under subsections (3) through (7) of this section;

(h) "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(2) Any corporation which is required by KRS 141.010 (14)(b) to allocate and apportion its net income shall allocate and apportion its net income as provided in this section.

(3) Rents and royalties from real or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsections (4) through (7) of this section.

(4) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible property are allocable to this state if and to the extent that the property is utilized in this state; or in their entirety if the taxpayer's commercial domicile is in this state and the taypayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental period of the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personalty is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(5) (a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if the property had a situs in this state at the time of sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(6) Interest is allocable to this state if the taxpayer's commercial domicile is in this state.

(7) (a) Patent and copyright royalties are allocable to this state in and to the extent that the patent or copyright is utilized by the payer in this state; or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or of the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized to the extent that printing or other publication originates in the state. If the basis of receipts from copyright does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(8) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor

plus the sales factor, and the denominator of which is three (3).

(a) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals, provided that such rental and such sub-rentals are reasonable. If the department determines that the annual rental or sub-rental rate is unreasonable, or if a nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value ~~of the~~ property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(b) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and

the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the state from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed

in this state than in any other state, based on costs of performance.

(9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(10) Public service companies and financial organization required by KRS 141.010(14)(b) to allocate and apportion net income shall allocate and apportion such income as follows:

(a) Nonbusiness income shall be allocated to this state as provided in subsections (4) through (7) of this section;

(b) Business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three (3). The payroll factor shall be determined as provided in subsection (8) (b) of this section. The property factor and sales factor shall be determined as provided by regulations promulgated by the department.

APPENDIX B

103 KAR 16:120. Apportionment and allocation; truck-lines, bus lines; airlines.

RELATES TO: KRS 141.120

PURSUANT TO: KRS Chapter 13a

NECESSITY AND FUNCTION: This regulation, under authority of KRS 141.120(10)(b), specifies how the factors for apportioning the income of interstate truckline, bus line, and airline companies are to be determined.

Section 1. General. (1) Business income of multi-state corporate truckline, bus line, or airline, shall be apportioned to Kentucky by multiplying the income by a fraction, the numerator of which is the sales factor plus the property factor plus the payroll factor, and the denominator of which is three (3).

(2) Nonbusiness income shall be allocated to Kentucky by KRS 141.120(3) to (7) and 103 KAR 16:060.

Section 2. Sales Factor. "Sales" means operating income as defined by the Interstate Commerce Commission (Civil Aeronautics Board for airlines). The sales factor is a fraction, the numerator of which is operating income assigned to Kentucky and the denominator of which is total operating income. Kentucky operating income is determined as follows: Total operating income shall be multiplied by a fraction the numerator of which is miles in Kentucky and the denominator of which is total miles operated.

Section 3. Property Factor. The property factor is a fraction, the numerator of which is the average value of tangible property sitused in Kentucky that is owned and used, and/or leased and used. The denominator is the average value of all tangible sitused property that is owned and used and/or leased and used. The average value of

tangible sitused property during the tax period shall be determined under the provisions of 103 KAR 16:080. The value of over-the-road equipment and of aircraft shall be excluded in determining the average value of both Kentucky and total property.

Section 4. Payroll Factor. The payroll factor shall be determined under the provisions of KRS 141.120(8)(b) and 103 KAR 16:090. (IC-12; 1 Ky. R. 224; eff. 1-8-75.)

APPENDIX C

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

OPINION

This appeal is from a final ruling of the Kentucky Revenue Cabinet where the appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978. During the years in question the appellant reported its income to Kentucky based upon its miles (truck) in Kentucky against its total miles everywhere. However, the Cabinet, in its audit used a three factor formula to determine their income. This formula is based on mileage in Kentucky, as compared to total mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

The appellant contends that the application of the Cabinet's apportionment method is unfair and:

1. Violates the Due Process rights of appellant;
2. Violates the Commerce Clause rights of appellant;
3. Violates legislative intent of The Uniform Division of Income for Tax Purposes Act (UDITPA) (KRS 141.120.

The appellant also claims that the Cabinet's assessment as to 1973 is barred by the statute of limitations.

Appellee argues that the appellant has waived its right to question the three factor formula by failing to petition for a different apportionment formula in accordance with KRS 141.120(9); and argues, of course, that the three factor formula is constitutional and fair.

This Board agrees that appellee failed to properly petition for the use of a different apportionment formula under KRS 141.120(9). However, the Board does not agree that appellant waived its right to question the application of the three factor formula.

On the primary issue, this Board is of the opinion that the three factor formula used by the Cabinet does fairly measure the income generated by appellant's business activities in Kentucky. The recent Supreme Court Case, *Container Corporation of America* v. *Franchise Tax Board,* answers and puts to rest the constitutional arguments made by this appellant.

Finally, the Board agrees with appellee on the Statute of Limitations questions. The six year statute of limitation clearly applies in this case. Therefore, the 1973 tax year will remain in the assessment.

Counsel for the appellee are directed to prepare proposed findings of fact, conclusions of law, and proposed order pursuant to this opinion for consideration by the Board within 30 days from the date of this opinion, with copy to be served upon appellee's counsel for comment within 15 days thereafter, It is clearly understood that the Board will prepare its own findings of fact and conclusions of law after the proposed findings and conclusions and comments thereto have been submitted.

This 9th day of April, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

KENTUCKY BOARD OF TAX APPEALS

File No. K82-R-56

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Order No. K-10305

FINDINGS OF FACT

1. This appeal is from a final ruling of the Kentucky Revenue Cabinet where the Appellant, Liquid Transporters, Inc., was assessed a deficiency of additional Kentucky corporation income taxes for the years 1973 through 1978.

2. The Appellant, Liquid Transporters, Inc., is in the business of transporting bulk commodities through authorities granted it by the Interstate Commerce Commission and the Kentucky Public Utilites Commission. During the years in question the Appellant reported its income to Kentucky based upon its miles (track) in Kentucky against its total miles everywhere. Appellee, in its audit, used the three factor formula prescribed by statute and regulation to determine their income. This formula is based on mileage in Kentucky, as to the mileage, as one factor and also based on taxpayer's property and payroll in the state and outside the state as factors.

3. The Appellant's method of determining its tax liability to the State of Kentucky does not reflect the full extent of its business activities in this state.

Forty percent of Appellant's miles occur in Kentucky. It has its corporate headquarters and commercial domicile here in Kentucky. It owns and leases real property here. It operates under the worker's compensation and unemployment insurance laws of this state. All dispatching is done from Kentucky. Most of its shipments originate from this state. It solicits its business from this state. It has its bank accounts and accountants in this state.

4. The three factor formula utilized by the Revenue Cabinet fairly measures the income generated by Appellant's business activities in the State of Kentucky.

5. Under the statute, KRS 141.120, a taxpayer may petition for use of some alternative to the statutory three factor formula. During the years in issue the Appellant made no such petition.

6. For the years 1973 the Appellant understated its taxable net income for Kentucky by more than 25%.

7. While the Kentucky legislature directed that the three factor formula should be applied to public service companies, it specifically directed that the Revenue Cabinet should develop regulations with respect to the determination of the property factor and the sales factor. KRS 141.120(10)(d). The regulations which were promulgated for trucking companies provided that the sales factor would be determined by mileage driven in the state divided by mileage driven everywhere. 103 KAR 16:120(2). The regulation also provides that the property factor will be determined by the value of the Kentucky property divided by the value of all property with the value of all over-the-road equipment excluded from the computation. 103 KAR 16:120(3).

8. There is some testimony that it was at the request of the trucking industry that over-the-road equipment was excluded from the property computation.

9. The primary rationale for excluding over-the-road equipment from the property factor is that, since this type of property must be assigned by mileage, inclusion of over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. Mileage, already makes up a full third of the formula through its use as the determining element in the sales factor.

10. In this case, it would be difficult to value Appellant's leased over-the-road equipment. This is because the leases in question include elements which are not properly attributable to the value of the leased equipment. For instance, in its typical lease, Liquid Transporters was paying not only for the property leased, but for a driver, insurance, repair and maintenance, fuel, oil, tires, batteries. tolls, taxes, licenses, substitute equipment, and other operating necessities for the equipment. If these leases were capitalized at eight times their value (the stautory method of capitalization) a gross distortion in the property factor would result.

11. By applying a three factor formula in which a full third of the formula is based on mileage and which fairly takes into account the taxpayer's property and payroll in the state and outside the state, Kentucky has arrived at a fair and reasonable income allocation and apportionment method which reflects the extent of Appellant's business activity in Kentucky.

CONCLUSIONS OF LAW

The burden of proof is upon the party seeking to vary from the statutory formula. *Ruby Construction Co., Inc.*

v. *Revenue,* Ky., App., 578 S.W.2d 248 (1979). The Appellant here has not carried its burden.

Since the three factor statutary formula fairly apportions the income of Appellant subject to Kentucky income tax, the assessment must be upheld and the Cabinet's final ruling affirmed.

Appellant's returns understated its taxable net income by more than 25%. Therefore the six year statute of limitations applies pursuant to KRS 141.210, and the assessment for the year 1973 is proper.

This 25th day of July, 1984.

Kentucky Board of Tax Appeals

(s) Garland W. Howard
Garland W. Howard, Chairman

Attest:

(s) Ellis A. Merrifield
Ellis A. Merrifield, Clerk

APPENDIX D

JEFFERSON CIRCUIT COURT

TWELFTH DIVISION

No. 84CI 06717

LIQUID TRANSPORTERS, INC. - - - - *Appellant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - *Appellee*

JUDGMENT AFFIRMING AND REVERSING IN PART MEMORANDUM OPINION

On July 25, 1984, the Kentucky Board of Tax Appeals affirmed the assessment against Liquid Transporters of additional Kentucky corporation income taxes for the years 1973 through 1978. Liquid Transporters appeals.

Appellant is represented by the Honorable Joseph L.T. Ardery and the appellee is represented by the Honorable Ross Carter. Both parties have filed exhaustive briefs and have orally argued this case on March 1, 1985.

In appeals pursuant to KRS 133.370, this Court is limited in scope. Under the statute, these actions are disposed of in a summary manner and the review is limited to determining whether or not:

"(a) The Board acted without or in excess of its powers;

(b) The Order, Decision or Award was procured by fraud;

(c) The Order, Decision or Award is not in conformity to the law;

(d) The Findings of Fact are an issue whether such Findings of Fact Support the Order, Decision or Award."

If the Findings of Fact are supported by substantial evidence and if the assessment conforms to the law, then the Decision must be affirmed. (*Trimble County Board of Supervisors* v. *Mullikin,* Ky., 438 S. W. 2d 524 (1968); *Department of Revenue* v. *Anaconda American Brass Company,* Ky., 435 S. W. 2d 65 (1968).

The appellant, Liquid Transporters, Inc. (hereinafter referred to as Transporters) carry bulk commodities by authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission. From 1973 through 1978, Transporters reported its income to the State of Kentucky based upon its truck miles traveled in Kentucky as comparide to its total miles traveled everywhere. The Department of Revenue found a deficiency for each of the years using the formula promulgated in regulation. (103 KAR 16:120(2)). Transporters makes the following arguments:

1. The Kentucky Allocation and Apportionment Formula does not fairly apportion the income of Transporters subject to the tax.
2. The Kentucky apportionment method violates the due process rights of Transporters.
3. The appellant did not waive its constitutional rights by failing to properly petition for the use of the straight mileage apportionment.
4. The 1973 assessment against Transporters is barred by the Statute of Limitations.

These arguments are addressed separately.

I. THE KENTUCKY ALLOCATION AND APPORTIONMENT FORMULA FAIRLY APPORTIONS THE INCOME OF APPELLANT SUBJECT TO KENTUCKY INCOME TAX.

Transporters argues that the Board should have followed the case of *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S. 653, 92 L.Ed. 1633 (1947). They contend that this case holds that the taxing scheme set up by the State be struck down by the Court.

Although Transporters cites certain phrases from the case, the ruling does not support the contention that the apportionment formula is improper. In Central Greyhound, a trucking company was taxed on its "gross receipts" where the trucks drove not only in New York but also in Pennsylvania and New Jersey. The Court held that New York cannot tax the company on 100% of the "gross receipts" when only 57.47% of the mileage was driven in New York. The tax must be "fairly apportioned" to the business done within the State by a "fair method of apportionment".

This case in no way holds that the straight mileage formula is *required* or that Kentucky's formula is not fair just because it is not based solely on mileage. The tax is fairly apportioned to the business done within the State. (*Container Corporation of America* v. *Franchise Tax Board,* 103 S.Ct. 2933 (~~1983~~)), 77 L. Ed. 2d 545; *Moorman Manufacturing Company* v. *Bair,* 98 S. Ct. 2340 (1978)).

The Container and Moorman cases uphold either single or multiple factor formulas used for apportionments. The Container case even proclaims that the constitution imposes no single fomula in the States. The formula must be fair and externally consistent. The three-factor formula based in equal parts as to payroll, sales and property has been approved.

II. KENTUCKY'S APPORTIONMENT METHOD DOES NOT VIOLATE THE DUE PROCESS RIGHTS OF TRANSPORTERS.

The facts found in this case not only show that Transporters traveled 40% of all of its miles in Kentucky, but it has its corporate headquarters and commercial domicile here. It owns and leases real property here. It benefits from the Worker's Compensation and Unemployment Insurance laws of this State. It does all its dispatching and most of its shipping from Kentucky. It solicits business within the State. It has bank accounts, accountants, and numerous other contacts within the Commonwealth of Kentucky, which it does not have with other States. In *Moorman Manufacturing Company* v. *Bair, supra,* the Court handed down two restrictions to states taxing interstate commerce done within the individual state is order to meet the due processs requirements of the Fourteenth Amendment of the U.S. Constitution. The restrictions were that:

1) No tax would be imposed, unless there is some minimal connection between those activities and the taxing state.

2) The income attributed to the state for tax purposes must be rationally related to values connected with the taxing state.

The Commonwealth's three-factor formula satisfies the above restrictions and fairly measures the income generated by appellant's business activities in this State. The formula which is applied for determining Transporters' income is basically as follows, to-wit:

$$\frac{\text{Kentucky Property}}{\text{All Property}} \text{ plus } \frac{\text{Kentucky Payroll}}{\text{All Payroll}} \text{ plus } \frac{\text{Kentucky Sales}}{\text{All Sales}}$$

Divide the sum by three and the result is equal to total "taxable" business income.

KRS 141.120(10(d) is a promulgating authority for development of regulations which were adopted by the Revenue Cabinet. The regulations privide that the sales factor would be determined by mileage driven in Kentucky divided by mileage driven everywhere. (103 KAR 16; 120(2)). The property factor would be determined by the value of all over-the-road equipment excluded from the computation. Transporters contends that this exclusion is unfair. However, if it were included, then logically it must be assigned mileage since a good portion of the over-the-road equipment is used outside the State and inclusion of the over-the-road equipment in the property factor would give undue emphasis to mileage in the overall formula. It is also noted that mileage is already considered in a third of the formula's makeup.

The Court cannot conclude that the three-factor formula which fairly takes into account Transporters nexus and relationships with the Commonwealth is unfair. It is also noted that the burden is on the party seeking to use some other method to show that the formula distorts or is unfair. (KRS 141.120(9); *Ruby Construction Company* v. *Revenue,* Ky. App., 578 S. W. 2d 248 (1979)). This has not been done and the Court concludes that the apportionment method does not violate Transporters due process rights.

III. BY FAILING TO PETITION IN ACCORDANCE WITH 141.120(9) FOR THE YEARS IN QUESTION, TRANSPORTERS HAS WAIVED ITS RIGHT TO QUESTION THE APPLICATION OF THE THREE-FACTOR FORMULA.

The Revenue Department argues that while the appellant has the right to petition for relief under KRS 141.120 (9), it waived that right by failing to file the proper petition. This, it contends, is a condition precedent in order to take advantage of KRS 141.120(9) and thus these rights were waived. (28 Am. Jur. 2d, Estoppel & Waiver, Sec. 164).

The provisions of Section 9 of KRS 141.120 provide as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this State, taxpayer may petition for or the department may require in respect to all or any part of the taxpayer's business activity if reasonable (a) separate accounting (b) the exclusion of any one or more of the factors (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

It is undisputed that Transporters did not petition the Department pursuant to this particular section for any of the years in question.

Transporters, without complying with this "relief" section, cannot now be heard to come forward and some five years later complain about the allocation formula. In this respect also, the Court believes that the Decision of the

Board of Tax Appeals is in conformity with the law. (KRS 141.120(9)).

IV. THE 1973 ASSESSMENT SHOULD BE BARRED BY THE STATUTE OF LIMITATIONS

Transporters filed its corporate income tax return for 1973 on March 15, 1974. Kentucky assessed additional tax with respect to 1973 on August 1, 1979. This was a period in excess of four years after the filing date.

The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

> 1. "As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer, the excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided. . . .
> a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be assessed at any time within six years after the return was filed".

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable"

to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitation when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes.

JUDGMENT

For the reasons set forth hereinafter in the Memorandum Opinion, it appearing that there is substantial evidence to support the Findings of Fact and Conclusions of Law and the ruling of the Kentucky Board of Tax Appeals and further that the Board did not err as to the assessment of the 1973 tax and the Court being further advised, the Decision of the Kentucky Board of Appeals is affirmed in part and reversed in part as it applies to the 1973 assessment. This is a final Order.

(s) Edwin Schroering, Jr.
Edwin A. Schroering, Jr., Judge

Date May 23, 1985

Copy To:

Joseph L.T. Ardery
Ross Carter

APPENDIX E

COURT OF APPEALS OF KENTUCKY

No. 85-CA-1850-MR
721 S. W. 2d 722

LIQUID TRANSPORTERS, INC., - - - - *Appellant,*

v.

REVENUE CABINET, Commonwealth of Kentucky, - - - - - - *Appellee.*

REVENUE CABINET, Commonwealth of Kentucky, - - - - - *Cross-Appellant,*

v.

LIQUID TRANSPORTERS, INC., - - *Cross-Appellee.*

November 7, 1986.

Discretionary Review Denied by Supreme Court January 13, 1987.

COOPER, Judge.

This is an appeal and cross-appeal from a judgment of the circuit court upholding a ruling of the Kentucky Board of Tax Appeals (hereinafter the Board). That ruling held that the statutorily prescribed method for apportioning business income subject to taxation for a corporation engaged in business within the Commonwealth was properly applied to the appellant. On direct appeal, the issue is whether the procedure set forth in the statute is an unconstitutional violation of both the Commerce and Due Process

Clauses of the United States Constitution. On cross-appeal, the issue is whether the circuit court acted correctly in ruling that the appellee's attempt to assess taxes for the 1973 year was effectively barred by the statute of limitations. KRS 141.210. Reviewing the record below, we affirm.

The essential facts giving rise to this litigation are as follows: In July of 1984, the Board affirmed a ruling issued by the appellee. Revenue Cabinet, Commonwealth of Kentucky, assessing additional taxes against the appellant, Liquid Transporters, Inc., for the years 1973-78. The assessment resulted from the appellee's following the procedure set forth in KRS 141.120(8), and the regulation promulgated under the statute, 103 KAR 16:120(2). Under authorization of the Interstate Commerce Commission and the Kentucky Public Utilities Commission, the appellant is authorized to carry bulk commodities throughout Kentucky and neighboring jurisdictions. The appellant reported its income in the years in question on the basis of truck mileage traveled in Kentucky in proportion to its total truck mileage traveled throughout the United States. This basis for reporting income differed from that set forth in the statute and also the regulation. As a result, the Board affirmed the additional assessment issued by the Revenue Cabinet. This finding was affirmed by the circuit court.

The circuit court specifically found that the formula set forth in the statute and the regulation resulted in a *fair* assessment of corporate income tax owed by the appellant. Additionally, it found that the apportionment formula set forth in the statute did not violate the appellant's constitutional right of due process. And, it ruled that the appellant had waived its right to question the constitutionality of the apportionment and allocation formula set forth in the statute as a result of its failure to petition the ap-

pellee for an alternative method of taxation in the years in question. KRS 141.120(9). Finally, it ruled that the attempt by the Revenue Cabinet to assess additional taxes for 1973 would be barred by the statute of limitations. KRS 141.120. It is from such judgment that the appellant now appears and the appellee cross-appeals.

Initially, the appellant argues that the three-factor formula set forth in KRS 141.120 is, on its face, unconstitutional. Specifically, it argues that applying such a formula to the income it earned for the years in question resulted in an unfair and overlapping system of taxation with respect to the amount of corporate income tax it paid to sister states. Before addressing such issue, this Court notes that during the years in question, with the exception of 1971, the appellant failed to petition the Department of Revenue for an alternative method of taxation as provided for in KRS 141.120(9). That section states as follows:

> (9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting;
>
> (b) The exclusion of any one or more of the factors;
>
> (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or
>
> (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Only for the taxable year 1971 did the appellant make an attempt to file such a petition, which was simply attaching the petition to the back of the 1971 income tax return. Although it is arguable that this failure effectively estops the appellant from arguing that the method of allocation and apportionment utilized by the Cabinet is unconstitutional, we find it unnecessary to reach this issue, given our ruling that the statutory scheme is both fair and reasonable, and not in violation of either the Commerce or Due Process Clauses of the Constitution.

Under the statutory scheme set forth in KRS 141.120, three factors are utilized in determining the amount of business income taxable by the Commonwealth: the percentage of property owned and operated in Kentucky to total property owned and operated by the corporation in question; the percentage of payroll paid out of this state to the total payroll of the corporation; and the percentage of Kentucky sales to total sales. This percentage is divided by three and multiplied by the total business income in determining the amount subject to Kentucky taxation. In effect, three factors—that of payroll, property, and sales — are utilized in determining the amount of business income subject to Kentucky taxation rather than simply one factor, such as the amount of miles driven within the state in proportion to total mileage driven.

Although this three-factor formula has been upheld and approved by the Court in *Butler Brothers* v. *McColgan,* 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942), as well as in *Container Corporation of America* v. *Franchise Tax Bd.,* 463 U. S. 159, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983), the appellant apparently argues that a one-factor formula, that of straight mileage apportionment, should be utilized. As authority for this argument it cites the decision of the Court in *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U.S.

653, 68 S. Ct. 1260, 92 L. Ed. 1633 (1947). We find *Central Greyhound* distinguishable. In effect, that Court ruled that the method for appropriating income to a state must be a fair method. By no means did it mandate a straight mileage method of apportionment. Rather, the Court ruled that under the existing taxing scheme of New York, an unapportioned gross receipt tax levied on an interstate business violated the Commerce Clause.

In *Container Corp., supra,* the Court endorsed the three-factor formula and stated that an indication of its fairness in a specific context is whether it exhibits internal and external consistency. By internal consistency, the Court stated that if such method were applied in every jurisdiction, it would result in no more than all the taxpayer's business income being taxed. Here, the appellant has failed to demonstrate that if the statutory scheme set forth in the statute were employed in all jurisdictions, more than a hundred percent of the taxpayer's business income would be taxed. Furthermore, as that Court stated: "a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States. . . ." at p. 557. And, it held that only a constituted mandated method of taxation could eliminate all overlapping taxation.

Besides affirming that an apportionment formula should possess internal consistency, the *Container Corp., supra,* Court held that it must possess an external consistency, a characteristic difficult to define. Specifically, the Court stated as follows:

> [T]he factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not

> have its source in the taxing State . . . Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted in that State'." *Id.* at p. 556.

Reviewing the record before this Court, we do not believe that the appellant has presented clear and cogent evidence that the business income generated by it and attributed to this Commonwealth is, in fact, "out of all appropriate proportion to the business transacted" within this state. Although the appellant argues that most of its revenue results from interstate travel in states other than Kentucky, the record reflects the fact that the appellant has its corporate headquarters and corporate domicile in this jurisdiction and both owns and leases real property here. Furthermore, it benefits from workers' compensation and unemployment insurance laws, and most of its bulk shipments originate from this state. Taken as a whole, we find that the evidence was substantial and supported the finding of both the Revenue Cabinet and the circuit court. As such, it will be upheld on appeal.

Finally, on cross-appeal, we concur with the findings of fact of the circuit court that the statute of limitations barred the assessment for the year 1973. In addressing such issue, the circuit court stated in its judgment the following:

"The provisions of KRS 141.210 with respect to the assessment of such taxes provides in pertinent part:

> 1. As soon as practicable after each return is received, the department shall examine and audit it. If the amount of tax as computed by the department is greater than the amount returned by the taxpayer, the

excess shall be assessed by the department within four years from the date the return was filed, except as hereinafter provided . . . a notice of the assessment shall be mailed to the taxpayer . . . (c) in the case of a return where a corporation understates its taxable net income or omits from taxable net income an amount properly includable therein or both which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be asserted at any time within six years after the return was filed.

Transporters contends the Statute of Limitations expired in four years while Revenue claims it was six years because Transporters had understated its "taxable" income by an excess of 25%.

The Court observes that KRS 141.210(c) was amended in 1974 (effective June 21, 1974) adding the word "taxable" to the statute. So at the time that Transporters filed its return in this case, the law was different. Prior to 1974, subsection (c) provided a six year Statute of Limitations when "net income" was understated by 25%. That was not the situation when the tax return was filed. Transporters did not understate their "net income" as envisioned in subsection (c) which was the prevailing law at that time. The amendment of June 26, 1974 should not be given retroactive application to the 1973 taxes."

We concur with the court's ruling.

The judgment of the circuit court is affirmed.

All concur.

APPENDIX F

SUPREME COURT OF KENTUCKY

86-SC-994-D
(85-CA-1850-MR & 85-CA-2598-MR)

LIQUID TRANSPORTERS, INC. - - - - *Movant*

v.

REVENUE CABINET, Commonwealth of Kentucky - - - - - - - *Respondent*

Jefferson Circuit Court
No. 84-CI-06717

ORDER DENYING DISCRETIONARY REVIEW

The motion of the movant for a review of the decision of the Court of Appeals is denied.

ENTERED January 13, 1987.

(s) Robert F. Stephens
Chief Justice

No. 86-1652

Supreme Court, U.S.
FILED
MAY 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - Appellant

versus

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - Appellee

On Appeal from the Court of Appeals of Kentucky

APPELLANT'S REPLY BRIEF

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No. 86-1652

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1986

LIQUID TRANSPORTERS, INC. - - - *Appellant*

v.

REVENUE CABINET, COMMONWEALTH OF KENTUCKY - - - *Appellee*

ON APPEAL FROM THE COURT OF APPEALS OF KENTUCKY

APPELLANT'S REPLY BRIEF

I. This Case Was Not Decided, and Could Not Have Been Decided, on a Non-Federal Basis.

The decision of the Kentucky Court of Appeals from which this appeal is taken was based on the Court's holding that Kentucky's income tax apportionment method for trucking companies is not void under either the Commerce Clause or the Due Process Clause. *Liquid Transporters, Inc.* v. *Revenue Cabinet,* 721 S. W. 2d 722, 724 (Ky. App. 1986); Jurisdictional Statement, Appendix A, at p. 4a. The decision from which this appeal is taken clearly was not decided on a non-federal basis.

The Revenue Cabinet argues that this case could have been decided on an "adequate, non-federal basis"

and, therefore, this appeal should be dismissed, or the decision below affirmed, under this Court's decision in *Jean* v. *Nelson,* 472 U. S. 846 (1985). See Motion to Dismiss or Affirm, p. 6.

The Revenue Cabinet argues that the Court of Appeals' decision could have been based on the alleged failure of Liquid Transporters[1] to take advantage of "procedural relief" granted by the Kentucky statute providing that a taxpayer "may petition"[2] for an alternate allocation and apportionment method, KRS 141.120(9); Jurisdictional Statement, Appendix F, at p. 30a.

This Court has stated that the question of the existence of a waiver of a federally guaranteed constitutional right is, itself, a federal question, controlled by federal law. This Court has stated it has a duty to make an independent examination of the evidence and the record to confirm that there has been the intentional relinquishment or abandonment of a known right or privilege required for such a waiver. *Brook-*

[1]This corporate appellant's compliance with the requirements of Rule 28.1 is contained on page 1 of the Jurisdictional Statement.

[2]The statute does not state that a decision not to petition will result in the loss of any rights. The Revenue Cabinet has never promulgated any regulations stating that any failure to petition under the statute will result in the loss of any rights, or otherwise dealing with the statute in any way. *Compare* KRS 131.110 and *International Society for Krishna Consciousness, Inc.* v. *Commonwealth,* 610 S. W. 2d 910 (Ky. App. 1980), in which the Kentucky Court of Appeals held that a failure to petition a state tax assessment under a statute stating the assessment would become final if a timely petition were not filed did *not* result in a waiver of rights under the United States Constitution.

hart v. *Janis*, 384 U. S. 1, 4 (1966). See also *Brewer* v. *Williams*, 430 U. S. 387, 403-404 (1977).[3]

This case thus could not have been decided on an "adequate, non-federal basis."

This Court held in the only case cited by the Revenue Cabinet on this issue, *Jean* v. *Nelson, supra,* that if a denial of rights *both* under a federal statute and related regulations *and* under the United States Constitution is alleged, it is not necessary or appropriate for courts below to reach the constitutional issues if a violation of the statute and regulations is or may be found. All courts are to avoid constitutional adjudication except where necessary.

Jean did not involve the alleged waiver of federal constitutional rights — itself a federal constitutional question.

The Revenue Cabinet incorrectly states at page 5 of its motion:

> The [Kentucky] Board [of Tax Appeals] correctly ruled from the evidence before it that Liquid Transporters had waived its right to use an alternate formula as it had failed to properly petition the Revenue Cabinet for a modification of the formula.

---

[3]The filing of tax returns using an apportionment method clearly described thereon can hardly be characterized as an intentional relinquishment of the right to use that method. This Court will not presume acquiescence in the loss of property rights guaranteed by the United States Constitution. See *Ohio Bell Telephone Co.* v. *Public Utilities Commission of Ohio*, 301 U. S. 292, 307 (1937).

In fact, the Board stated in its Opinion entered April 9, 1984 (Jurisdictional Statement, Appendix D, at p. 18a) that "the Board does not agree that [Liquid Transporters] waived its right to question the application of the three-factor formula."

The Board stated in its Findings of Fact and Conclusions of Law entered July 25, 1984 (Jurisdictional Statement, Appendix D, at p. 21a) that, in its view, Liquid Transporters made no petition for the use of an alternate method during the years at issue. But it did not state either as a finding of fact or a conclusion of law that the failure to petition during those years constituted a waiver. Such a statement would, of course, have been in direct contradiction to the Board's own Opinion.

Thus, the finder of fact in this case refused to find a waiver. Whether the existence of a waiver is deemed an issue of fact or of law, this Court has stated that it is a federal question, controlled by federal law and appropriate for this Court's review. *Brookhart* v. *Janis, supra.*

Even if the Kentucky Court of Appeals had decided this case against Liquid Transporters on the waiver issue (which it did not) that decision would be appealable to this Court as a substantial federal question.

Were the standard otherwise, States could deny citizens their federal constitutional rights simply by asserting that they had waived those rights, thereby precluding review by this Court.

II. This Case Presents Substantial Federal Questions Not Previously Decided by This Court.

This Court has never determined whether Kentucky's three-factor apportionment formula for trucking companies satisfies the Due Process Clause and the Commerce Clause.

The Revenue Cabinet's motion does not dispute, and indeed cannot dispute, the unique character of Kentucky's formula. It's argument, stated directly, is that *any* three-factor apportionment formula somehow based on property, payroll, and sales, *must* satisfy the United States Constitution. If this Court allows that argument to prevail, then no interstate corporation's property is safe.

The Revenue Cabinet repeats at pages 3 and 8 of its motion the misstatement that Liquid Transporters is contending that the "uniqueness" of Kentucky's formula "makes it" violative of the United States Constitution and Kentucky "must use the single factor of mileage to apportion income."

We do not deny the substantial discretion the States have to select apportionment methods. The United States Constitution prohibits, however, the use of apportionment factors in a patently arbitrary and irrational manner, inevitably leading to double taxation and the subjection of the taxpayer to the power of the various States to levy their respective taxes on the multiples of the taxpayer's net income shown here.

To tax more than twice the income that may be taxed under an apportionment formula this Court has

found unquestionably fair is to go too far. *Central Greyhound Lines, Inc. of New York* v. *Carroll E. Mealey,* 334 U. S. 653, 663 (1947).

To arbitrarily eliminate from a property factor all the taxpayer's property outside the taxing jurisdiction and assign to the taxing State in a payroll factor all of the wages for work outside the taxing jurisdiction is to violate that reasonable sense of how income is generated that results in the "external consistency" this Court has required. *Container Corporation of America* v. *Franchise Tax Board,* 463 U. S. 159, 169 (1983).

Every State other than Kentucky has the power under the United States Constitution to tax a portion of Liquid Transporters' net income equal to the mileage driven in that State. Safe in that knowledge, most other States actually use that method. Sixty-three percent of this taxpayer's net income is subject to tax by States other than Kentucky.

Kentucky's attempt to tax 79 percent of the net income of Liquid Transporters violates the United States Constitution.

CONCLUSION

For these reasons, this Court should overrule the Revenue Cabinet's motion and note probable jurisdiction of the appeal.

Respectfully submitted,

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